DOCKET

No. 86-1672-CFX
Status: GRANTED

Title: Commissioner of Internal Revenue, Petitioner
v.
Jesse C. Bollinger, et al.

Docketed:
April 16, 1987

Court: United States Court of Appeals
for the Sixth Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: Hembree,Charles R.

Entry	Date	Note	Proceedings and Orders
1	Feb 18 1987		Application for extension of time to file petition and order granting same until April 16, 1987 (O'Connor, February 19, 1987).
2	Apr 16 1987	G	Petition for writ of certiorari filed.
3	May 15 1987		Brief of respondents in opposition filed.
4	May 19 1987		DISTRIBUTED. June 4, 1987
5	Jun 8 1987		Petition GRANTED.
			**********
6	Jun 19 1987	G	Motion of the Solicitor General to dispense with printing the joint appendix filed.
7	Jun 26 1987		Motion of the Solicitor General to dispense with printing the joint appendix GRANTED.
9	Jul 21 1987		Order extending time to file brief of petitioner on the merits until August 23, 1987.
10	Aug 12 1987		Record filed.
11	Aug 19 1987		Order further extending time to file brief of petitioner on the merits until September 6, 1987.
12	Sep 8 1987		Brief of petitioner CIR filed.
14	Sep 15 1987		Order extending time to file brief of respondent on the merits until November 6, 1987.
15	Oct 19 1987		Record filed.
16	Nov 6 1987		Brief amici curiae of Gary R. Frink, et al. filed.
17	Nov 6 1987		Brief of respondents Jesse C. Bollinger Jr., et al. filed.
18	Nov 23 1987		SET FOR ARGUMENT. Wednesday, January 13, 1988. (1st case).
19	Nov 23 1987		CIRCULATED.
20	Jan 6 1988	X	Reply brief of petitioner CIR filed.
21	Jan 13 1988		ARGUED.

PETITION FOR WRIT OF CERTIORARI

86 1672

No.

In the Supreme Court of the United States

OCTOBER TERM, 1986

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JESSE C. BOLLINGER, JR., ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

Whether a corporation formed by the controlling partners of a real estate partnership to hold title to property, and to obtain financing that the partnership itself could not obtain, can be disregarded for federal income tax purposes on the theory that it is merely an "agent" of the partnership.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Edward H. Peter, Jr., Mary H. Peter, Paul W. Hensley, Mary N. Hensley, Suz-Anne C. Bollinger, and Jacqueline Bollinger were also petitioners in the Tax Court and are respondents here.

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In the Supreme Court of the United States

OCTOBER TERM, 1986

No.

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v.

JESSE C. BOLLINGER, JR., ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-11a) is reported at 807 F.2d 65. The opinion of the Tax Court (App., *infra*, 14a-34a) is unofficially reported at 48 T.C.M. (CCH) 1443.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 12a-13a) was entered on December 2, 1986. On February 19, 1987, Justice O'Connor extended the time

for filing a petition for a writ of certiorari to and including April 16, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Respondent Jesse C. Bollinger, Jr., was a real estate developer. Individually and in partnership with others, he constructed eight apartment complexes in Kentucky.[1] The other respondents were partners in some of those ventures. Construction financing was not available to the partnerships[2] directly because the market interest rate exceeded the maximum rate that could be charged to noncorporate borrowers under Kentucky's usury law. The usury restriction, however, did not apply to corporate borrowers. To avoid the usury problem, a pair of corporations were used to hold title to the properties and to borrow the funds for development. Bollinger formed a Kentucky corporation named Creekside, Inc., of which he was the sole stockholder, to act as the borrower and title-holder for all of the ventures except one. Cloisters, Inc., a Kentucky corporation in which Bollinger had a 50% stock interest, acted as the borrower and title-holder for that other venture. App., *infra*, 2a-3a.

Each partnership entered into a side agreement with the corporation to which title had been transferred. These agreements provided that the corporation would hold title to the property as agent of the partnership for the sole purpose of securing financ-

[1] The apartment complexes are listed at App., *infra*, 2a-3a n.1.

[2] For convenience, we use the term "partnerships" to include noncorporate sole proprietorships. A separate venture was formed to develop each apartment complex.

ing. No provision was made in any of the agreements for payment of a fee to the corporation. Each partnership, however, agreed to indemnify the corporation for any liabilities arising in the course of its duties. In each instance, the corporation executed the loan documents, and the partners personally guaranteed the loans. App., *infra*, 4a-5a, 20a n.4, 31a-32a.

For the tax years at issue (ranging variously from 1969 to 1977), each partnership reported on its partnership tax returns the expenses incurred and receipts generated in constructing and operating its respective apartment complex. Respondents in turn claimed their distributive shares of those expenses as loss deductions on their individual tax returns. On audit, the Commissioner disallowed those deductions, pointing out that the expenses were incurred by the corporations that borrowed the money and held title to the properties, not by the partnerships. The Commissioner therefore determined that the expenses were not deductible by respondents (App., *infra*, 5a).

2. Respondents sought redetermination of the deficiencies in the Tax Court. Relying on an inference from this Court's decision in *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422 (1949), the Tax Court held that the corporations formed and utilized to obtain financing were the mere "agents" of the partnerships that they served. The court therefore concluded that the corporations could be disregarded for tax purposes and that the partnerships were the proper entities to report the deductions generated by the construction and operation of the apartment complexes. In so holding, the Tax Court relied on its prior decisions in *Roccaforte* v. *Commissioner*, 77 T.C. 263 (1981), rev'd, 708 F.2d 986 (5th Cir.

1983), and *Ourisman* v. *Commissioner*, 82 T.C. 171 (1984), rev'd, 760 F.2d 541 (4th Cir. 1985).

3. The court of appeals affirmed (App., *infra*, 1a-11a). It expressly "decline[d] to follow the Fourth Circuit's view, as expressed in *Ourisman*" (*id.* at 11a), which requires the demonstration of an arm's-length agency arrangement in order for a corporate-shareholder relationship to be recognized as a true corporate agency under *National Carbide* (*id.* at 9a). Rather, the Sixth Circuit concluded, the corporate nominees should be treated as agents because they "acted like agents" (*id.* at 11a). The court of appeals acknowledged the general rule that a corporation used for legitimate business purposes is a discrete entity that is taxed separately from its shareholders. Noting that respondents had used their corporations for the sole purpose of complying with state usury laws, however, the court said that this was not "a situation where a taxpayer has embraced the advantages of doing business as a corporation and so, in fairness, must be held to the burdens as well as the benefits of the corporate form" (*id.* at 8a).

REASONS FOR GRANTING THE PETITION

The decision of the court of appeals directly conflicts with the decisions of the Fourth Circuit in *Ourisman* v. *Commissioner*, *supra*, and *Frink* v. *Commissioner*, 798 F.2d 106 (1986), petition for cert. pending, No. 1151 (filed Jan. 13, 1987). The decision below also conflicts with the decisions of the Fifth Circuit in *Roccaforte* v. *Commissioner*, *supra*, and *George* v. *Commissioner*, 803 F.2d 144 (1986), petition for cert. pending, No. 86-1152 (filed Jan. 13, 1987). For the reasons set forth in our consolidated

response to the petitions in *Frink* and *George*,[3] we believe that those decisions are correct and that the court below seriously misconstrued the import of this Court's holdings in *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436 (1943), and *National Carbide*. As further explained in that brief, we believe that the issue presented by this case has sufficient administrative importance to warrant this Court's resolution of the conflict in the circuits. In the event the Court grants certiorari in *Frink* and *George*, it would be appropriate to hold this case pending the disposition of those cases.

CONCLUSION

The petition should be disposed of as appropriate in light of the disposition of the petitions in *Frink* v. *Commissioner*, No. 86-1151, and *George* v. *Commissioner*, No. 86-1152.

Respectfully submitted.

CHARLES FRIED
Solicitor General

APRIL 1987

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[3] We are furnishing respondents' counsel with a copy of our consolidated brief in Nos. 86-1151 and 86-1152.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 85-1825

JESSE C. BOLLINGER, JR.; EDWARD H. PETER, JR. and MARY H. PETER; PAUL W. HENSLEY and MARY N. HENSLEY; JESSE C. BOLLINGER, JR. and SUZ-ANNE BOLLINGER; JESSE C. BOLLINGER, JR. and JACQUELINE BOLLINGER; JESSE C. BOLLINGER, JR. and SUZ-ANNE C. BOLLINGER, PETITIONERS-APPELLEES

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT-APPELLANT

On Appeal from the United States Tax Court

Decided and Filed December 2, 1986

Before: ENGEL and NORRIS, Circuit Judges; and COHN, District Judge.*

ALAN E. NORRIS, Circuit Judge. Respondent, Commissioner of Internal Revenue, appeals from orders of the United States Tax Court allowing to petitioners income tax deductions for losses generated

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* The Honorable Avern Cohen, United States District Judge, Eastern District of Michigan, sitting by designation.

by the construction and operation of apartment complexes.

Because the Tax Court made extensive findings of fact, the recitation of facts which follows is a summary of those findings.

Petitioner, Jesse C. Bollinger, was a real estate developer who, both individually and in partnership with other petitioners, developed a number of apartment complexes in Kentucky. In order to obtain construction financing, financial institutions required that the nominal debtor be a corporate nominee of the sole proprietorship or partnership seeking the financing. Accordingly, record title to the various properties was held by a corporation as a device to comply with Kentucky law, which provided that lending money to a non-corporate borrower at the market rate of interest prevailing at the time in question was usurious.[1]

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[1] The Tax Court developed a chart showing the apartment complexes constructed, the entities constructing them, the interest of the individuals in the various constructing entities, and the corporate nominee holding title:

Apartment Complex	Partnership	Individual's Interest in the Partnership: Bollinger	Peter	Hensley	George Martin	Samuel Zell	Robert Laurie	Title
1. Creekside North *	*	100%						Creekside, Inc.[1]
2. Carriage Hill	Carriage Hill	66 2/3%		33 1/3%				Creekside, Inc.
3. Creekside South	Creekside South	50%	50%					Creekside, Inc.
4. Les Chateaux	Les Chateaux	33 1/3%	33 1/3%	33 1/3%				Creekside, Inc. (Sold Sept. 1971)
5. Lamplighter	Lamplighter	33 1/3%	33 1/3%	33 1/3%				Creekside, Inc.
6. Two Lakes	Two Lakes: 7/16/71-9/10/74	50%				50%		Creekside, Inc.
	9/10/74-2/6/75	2%				98%		Howard Walker, Trustee
	After 2/6/75	0				100%		Howard Walker, Trustee

The circumstances surrounding Bollinger's development of Creekside North Apartments are typical of those related to the other developments. When he sought a construction loan and permanent financing for the project, he was advised by financial institutions that, in view of Kentucky usury laws, they would require that Bollinger's corporate nominee be the debtor and record titleholder. He obtained a commitment for permanent financing from Massachusetts Mutual Life Insurance Company, in which the company agreed to make a loan to "the corporate nominee of Jesse C. Bollinger, Jr."; the loan was to be secured by a mortgage on the apartments and by a personal guaranty from Bollinger.

After consulting with his accountant and attorney, Bollinger incorporated Creekside, Inc., for the sole purpose of having a corporate nominee for securing financing for the development of his apartment projects. He was the corporation's sole shareholder. Bollinger and Creekside, Inc., entered into an agreement which generally provided that the corporation would hold title to Creekside North Apartments, as

Apartment Complex	Partnership	Individual's Interest in the Partnership: Bollinger	Peter	Hensley	George Martin	Samuel Zell	Robert Laurie	Title
7. Ski Lodge *	*	100%						Creekside, Inc. (Sold 1975)
8. Cloister	Cloister 7/15/74-1/4/74	50%			50%			Cloisters, Inc.[2] (Until 12/31/74)
	1/4/74-11/5/75	9 1/2%			9 1/2%	81%		Greenland Vistas, Inc.[3]
	After 11/5/75	0			0		19%	(After 12/31/74)

* Sole proprietorship.

[1] Creekside, Inc., a Kentucky corporation wholly owned by Bollinger.
[2] Cloisters, Inc., a Kentucky corporation wholly owned equally by Bollinger and Martin.
[3] Greenland Vistas, Inc., a Delaware corporation in which petitioners had no interest.

Bollinger's agent, only for the purpose of securing temporary and permanent financing of the project.

To finance construction of the apartments, Bollinger, through Creekside, Inc., borrowed the funds from Citizens Fidelity Bank and Trust Company. The corporation executed all the loan documents, and then transferred the loan proceeds to Bollinger's individual account.

Bollinger acted as general contractor during the struction of Creekside North Apartments, and costs of construction were paid from his construction account. Upon completion, Bollinger, through Creekside, Inc., obtained permanent financing from Massachusetts Mutual Life, with the loan being secured by a mortgage upon the apartments and a partial personal guaranty by Bollinger. The loan proceeds were used to pay off the construction loan from Citizens Fidelity.

The Tax Court also found that Bollinger intended to retain all but record title to the apartment complex; that he intended that the corporation would convey record title to him as soon as feasible; that no tax-avoidance scheme was present; and that, by incorporating Creekside, Inc., Bollinger sought none of the traditional insulating benefits of a corporate shareholder. Bollinger employed a resident manager to rent the apartments, execute leases, collect rents, and maintain operating records.

Operation of Creekside North Apartments generated losses in 1969, 1971, 1972, 1973, and 1974, and ordinary income in 1970, 1975, 1976, and 1977. Both the income and losses were reported by Bollinger on his individual income tax returns.

Pursuant to a substantially identical pattern, petitioners secured financing for the construction of the other apartment complexes through the use of a

corporate nominee. Each partnership actively managed its apartment complex and reported income and losses on its partnership tax return. Petitioners, in turn, reported their distributive shares of the partnership income and losses on their individual returns. Creekside, Inc., acted as corporate nominee for six of these projects, and Cloisters, Inc. (which was owned equally by Bollinger and another investor), as nominee for the seventh project. The lenders regarded Bollinger or the respective partnerships as the owners of the apartments, required partial personal guaranties from them, and looked to them for repayment. Creekside, Inc., and Cloisters, Inc., had no liabilities, assets, employees or bank accounts, nor did they manage the apartment complexes.

The Commissioner disallowed the loss deductions claimed by Bollinger and the other partners, taking the position that the losses were those of the corporation which held title to the real estate.

In siding with petitioners, the Tax Court held that they had clearly established that the corporations were acting as agents, and the losses were therefore attributable to the sole proprietorships or partnerships.

The manifest purpose of the income tax is to tax income to those persons or entities that earn or otherwise create the right to receive income and enjoy its benefit when paid. *Helvering v. Horst*, 311 U.S. 112, 119 (1940); 26 U.S.C. §§ 1 and 11. Normally, the tax consequences of business transactions involving real property will fall upon its owner, since that is who customarily conducts the business and has the right to collect and enjoy the income. However, it does not follow that a nominal owner will be taxable, where there is transferred to him, as agent, the bare

legal title, with the equitable owner retaining for himself the real and beneficial ownership.

The difficulty, in situations where the purported principal-equitable owner has an ownership interest in the corporation which holds nominal title, lies in determining whether there is a true agency relationship between the two, or whether there is such a kinship and similitude between the two, that the purpose of the income tax would be thwarted if an agency relationship were to be recognized. *See, e.g., Moline Properties, Inc. v. Comm'r of Internal Revenue*, 319 U.S. 436 (1943).

The Supreme Court, in *National Carbide Corp. v. Comm'r of Internal Revenue*, 336 U.S. 422 (1949), enunciated principles which are instructive in the resolution of this appeal. That case involved an arrangement, formalized by contract, where a parent corporation utilized its wholly owned subsidiaries as operating companies to manufacture and sell goods. Under the contract, the parent provided working capital, executive management, and office facilities to the subsidiaries, termed "agents," which, in turn, paid substantially all the profits from their manufacturing and sales operations to the parent. The Commissioner took the position that all the income turned over to the parent was taxable to the subsidiaries.

The Supreme Court sided with the Commissioner, disregarded the agency agreement, and noted that, under the circumstances of that case, the parent and subsidiaries operated with such oneness of purpose that the enterprise could as well have been conducted by a single corporate entity. 336 U.S. at 436. Because the agency contract added nothing to the relationship which existed in fact, it could be disregarded so that the tax consequences might follow the reality of the circumstances.

However, the Supreme Court pointed out that this conclusion did not foreclose under all circumstances a "true corporate agent . . . from handling the property and income of its owner-principal without being taxable therefor." 336 U.S. at 437. Where generally recognized attributes of an agency relationship are present,[2] a controlled corporation can still be a true agent if its relations with its principal are not dependent upon the fact that it is owned by its principal, and its business purpose is the carrying on of the normal duties of an agent. *Id.* In other words, inquiry must be made whether the agent would have made the agreement if the principal were not its owner and, conversely, whether the principal would have undertaken the relationship if the agent were not its corporate creature. *See Harrison Property Management Co., Inc. v. United States*, 475 F.2d 623 (Ct. Cl. 1973), *cert. denied*, 414 U.S. 1130 (1974).

Because one would not expect an independent agent to perform all the work and then turn over the profits to its principal, in exchange for only nominal compensation, it is readily apparent that the purported agency relationship in *National Carbide* could not have existed in the absence of ownership and control of the subsidiary.

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[2] The Supreme Court listed these attributes:

> Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists.

336 U.S. at 437.

By contrast, holding nominal title is the kind of task customarily undertaken by independent agents. Thus, it cannot be said that the agency relationship in this case was dependent upon the fact of common ownership and control, in the sense that in the absence of common ownership and control an agent would not assume the duty of holding nominal title, and a principal would not entrust that duty to an agent. A corporation unrelated to the principals could just as well have been entrusted to hold nominal title to avoid usury problems, while the principals retained the real and beneficial functions of property ownership.

The Tax Court observed that petitioners desired to operate their businesses either as sole proprietorships or partnership, and were thwarted in completely doing so only by the practical requirements that they form corporations in order to comply with state usury laws. They did not attempt to avail themselves of the normal benefits of doing business in the corporate form; indeed, they conducted the businesses in individual and partnership capacities, remaining subject to the claims of creditors and others. Nor did they use the corporations as part of a tax-avoidance scheme. This is not, therefore, a situation where a taxpayer has embraced the advantages of doing business as a corporaton and, so, in fairness, must be held to the burdens as well as the benefits of the corporate form.

Accordingly, the Tax Court did not err in finding that the attributes of a true agency relationship were present under the circumstances presented by this case, and the decision of the Tax Court is consistent with the Supreme Court's opinion in *National Carbide*.

As one might expect, the factual situation before us is not unique; it has been the subject of review by other Courts of Appeals. In a case involving similar facts, *Ourisman v. Comm'r of Internal Revenue*, 760 F.2d 541 (4th Cir. 1985), the Fourth Circuit reversed a holding by the Tax Court that a corporate nominee was a true agent of the developer-partnership. In doing so, the court rejected the Tax Court's understanding that the requirement of *National Carbide*, that relations between the agent and principal must not be dependent upon the fact that the agent is owned by the principal, is satisfied where the corporate nominee acted no differently than an independent agent would have acted if the agent had bargained with its principal for its services at arm's length. Instead, the Fourth Circuit assigned a "literal" interpretation to that requirement, holding that the taxpayer's evidence must establish that the agency relationship was, in fact, an arm's length arrangement. This, in essence, is the position we are urged by the Commissioner to adopt. A similar result was reached in *Roccaforte v. Comm'r of Internal Revenue*, 708 F.2d 986 (5th Cir. 1983), although that case is easily distinguishable on its facts.[3]

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[3] The Commissioner also relies upon an opinion of the Court of Appeals for the Federal Circuit as supporting its position [*Vaughn v. United States*, 740 F.2d 941 (Fed. Cir. 1984)], but that case is also readily distinguishable upon its facts since, unlike the instant case, the activities of the purported corporate agent were inconsistent with a claim of agency. Moreover, in a later case, *Raphan v. United States*, 759 F.2d 879 (Fed. Cir.), *cert. denied*, 106 S.Ct. 129 (1985), that same Court of Appeals affirmed a judgment of the Court of Claims which had held that a principal-agency relationship did exist, and approved a review by the trial court of the *National Carbide* factors which was strikingly similar to the review

The Fourth Circuit's reading of the Supreme Court's requirement is subject to the criticism that it exalts form over substance, when the facts of that case are viewed in the context of the court's own characterization of its holding:

> Such a result simply recognizes the fact that if the agency relationship could not exist but for the shareholders' ownership and control of the corporate agent, the alleged agency relationship is nothing more than a manifestation of the underlying corporation-shareholder relationship and that the corporation therefore must be regarded as a separate taxpaying entity under our system of separate taxation of corporations.

760 F.2d at 549.

In our view, when the evidence establishes that the attributes of an agency are present, and the corporate nominee conducts itself no differently than would an independent agent which had bargained with its principal for its services at arm's length, then, even under the Fourth Circuit's "but for" test, a true principal-agent relationship has been proved. When the Supreme Court, in *National Carbide*, said that, under certain circumstances, a true corporate agent is not foreclosed from handling the property and income of its owner-principal without being taxable, it could not have contemplated so strict a reading of circumstances that, as a practical matter, the existence of a true agency would be foreclosed. What the Supreme Court demanded was an inquiry into the

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undertaken in this case by the Tax Court. *See Raphan v. United States*, 3 Cl. Ct. 457 (Cl. Ct. 1983), *aff'd in part, rev'd in part*, 759 F.2d 879 (Fed. Cir.), *cert. denied*, 106 S.Ct. 129 (1985).

actual substance of the relationship to determine if an agency existed in fact. Here, by any realistic assessment, the corporations acted like agents. When one surveys the circumstances of this case, one is hard-pressed to divine the harm which must be guarded against by adopting the Commissioner's position. Accordingly, we decline to follow the Fourth Circuit's view, as expressed in *Ourisman*.

The orders of the Tax Court are affirmed.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 85-1825

JESSE C. BOLLINGER, JR., ET AL.,
PETITIONERS-APPELLEES

V.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLANT

Before: ENGEL and NORRIS, Circuit Judges; and
COHN, District Judge.

[Filed Dec. 2, 1986]

JUDGMENT

ON APPEAL from a decision of the Tax Court of the United States.

THIS CAUSE came on to be heard on the transcript of record from the said Tax Court and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the

decision of the said Tax Court in this cause be and the same is hereby affirmed.

Each party is to bear its own costs on appeal.

ENTERED BY ORDER OF THE COURT

JOHN P. HEHMAN
Clerk

/s/ John P. Hehman
Clerk

Issued as Mandate: December 30, 1986

A True Copy.

Attest:

/s/ Tom Bennignus
Deputy Clerk

APPENDIX C

T. C. Memo. 1984-560

UNITED STATES TAX COURT

Docket Nos. 5883-78, 5884-78, 5885-78, 5886-78, 5887-78, 17521-80, 5430-81, 5431-81, 5432-81.

JESSE C. BOLLINGER, JR., ET AL[1]., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Filed October 18, 1984

[1] Cases of the following petitioners are consolidated herewith: Edward H. Peter, Jr., and Mary H. Peter, docket No. 5884-78; Paul W. Hensley and Mary N. Hensley, docket No. 5885-78; Jesse C. Bollinger, Jr., and Suz-Anne Bollinger, docket No. 5886-78; Jesse C. Bollinger, Jr., and Jacqueline Bollinger, docket No. 5887-78; Jesse C. Bollinger, Jr., and Suz-Anne C. Bollinger, docket No. 17521-80; Edward H. Peter, Jr., and Mary H. Peter, docket No. 5430-81; Jesse C. Bollinger, Jr., and Suz-Anne C. Bollinger, docket No. 5431-81; Paul W. Hensley and Mary N. Hensley, docket No. 5432-81.

MEMORANDUM FINDINGS OF FACT AND OPINION

WILES, *Judge*: Respondent determined the following deficiencies in petitioners' Federal income taxes:

Petitioner	Docket No.	Taxable Year	Deficiency
Jesse C. Bollinger, Jr.	5883-78	1971	$59,989.91
		1972	3,622.44
Edward H. Peter, Jr. and Mary H. Peter	5884-78	1969	3,617.64
		1970	25,227.36
		1971	27,406.41
		1972	3,576.37
		1973	93,571.11
Paul W. Hensley and Mary N. Hensley	5885-78	1967	1,833.82
		1969	3,021.17
		1970	3,653.99
		1971	12,901.76
		1972	5,545.05
		1973	6,335.24
Jesse C. Bollinger, Jr., and Suz-Anne Bollinger	5886-78	1973	103,712.86
Jesse C. Bollinger, Jr., and Jacqueline Bollinger	5887-78	1969	32,986.91
		1970	28,273.84
Jesse C. Bollinger, Jr., and Suz-Anne Bollinger	17521-80	1976	110,823.25
Edward H. Peter, Jr., and Mary H. Peter	5430-81	1976	35,161.66
		1977	99,060.34
Jessee C. Bollinger, Jr., and Suz-Anne C. Bollinger	5431-81	1977	84,553.74
Paul W. Hensley and Mary N. Hensley	5432-81	1977	8,876.97

After concessions by the parties, the sole issue for decision is whether the losses generated by the construction and operation of various apartment com-

plexes are attributable to the partnerships which operated the apartment buildings or to the corporation which was created to act as an agent for the partnerships for certain limited purposes.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly.

Petitioners, Jesse C. Bollinger, Jr. (hereinafter Bollinger), and Suz-Anne C. Bollinger, husband and wife, resided in Glenview, Kentucky, when they filed petitions herein. Jesse C. and Suz-Anne C. Bollinger filed joint Federal income tax returns for their 1973, 1974, 1975, 1976, and 1977 taxable years with the Internal Revenue Service Center in Memphis, Tennessee. Petitioner Jacqueline Bollinger (Bollinger's former wife) resided in Louisville, Kentucky, when she filed her petition herein. Petitioners, Jesse C. and Jacqueline Bollinger, filed joint Federal income tax returns for 1969 and 1970 taxable years with the Internal Revenue Service Center in Memphis, Tennessee. Bollinger filed his individual Federal income tax returns for his 1971 and 1972 taxable years with the Internal Revenue Service Center in Memphis, Tennessee.

Petitioners, Edward H. Peter, Jr., (hereinafter Peter) and Mary H. Peter, resided in Louisville, Kentucky, when they filed their petitions herein. Edward H. and Mary H. Peter, filed joint Federal income tax returns for their 1969, 1970, 1971, 1972, 1973, 1974, and 1975 taxable years, and an amended tax return for their 1973 taxable year, with the Internal Revenue Service Center in Memphis, Tennessee.

Petitioners, Paul W. Hensley (hereinafter Hensley) and Mary N. Hensley, husband and wife, resided in Lexington, Kentucky, when they filed their petitions herein. Paul W. and Mary N. Hensley, filed joint Federal income tax returns for their 1969, 1970, 1971, 1972, 1973, 1974, 1975, 1976, and 1977 taxable years with the Internal Revenue Service Center in Memphis, Tennessee.

During the years in issue, Bollinger was engaged in the business of real estate development. Bollinger, either individually or in partnership with others, developed the following apartment complexes in the State of Kentucky: Creekside North Apartments; Carriage Hill Apartments; Creekside South Apartments; Les Chateaux Apartments; Lamplighter Apartments; Two Lakes Apartments; Ski Lodge Apartments; and Cloister Apartments. In order to obtain construction financing for the various apartment complexes, financial institutions required that the nominal debtor be a corporate nominee of the partnership,[2] and accordingly, record title to the various properties was held by the corporate borrower. The following chart shows the apartment complex constructed, the partnership constructing the complex, the individual's interest in the partnership, and the corporate nominee holding title:

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[2] For purposes of this opinion the term partnership includes sole proprietorship.

Apartment Complex	Partnership	Individual's Interest in the Partnership: Bollinger	Peter	Hensley	George Martin	Samuel Zell	Robert Laurie	Title
1. Creekside North*	*	100%						Creekside, Inc.[1]
2. Carriage Hill	Carriage Hill	66 2/3%		33 1/3%				Creekside, Inc.
3. Creekside South	Creekside South	50%	50%					Creekside, Inc.
4. Les Chateaux	Les Chateaux	33 1/3%	33 1/3%	33 1/3%				Creekside, Inc. (Sold Sept. 1971)
5. Lamplighter	Lamplighter	33 1/3%	33 1/3%	33 1/3%				Creekside, Inc.
6. Two Lakes	Two Lakes:							
	7/16/71-9/10/74	50%				50%		Creekside, Inc.
	9/10/74-2/6/75	2%				98%		Howard Walker, Trustee
	After 2/6/75	0				100%		Howard Walker, Trustee
7. Ski Lodge*	*	100%						Creekside, Inc. (Sold 1975)
8. Cloister	Cloister							
	7/15/73-1/4/74	50%			50%			Cloisters, Inc.[2] (Until 12/31/74)
	1/4/74-11/5/75	9 1/2%			9 1/2%	81%		Greenland Vista, Inc.[3]
	After 11/5/75	0			0		19%	(After 12/31/74)

* Sole proprietorship.

[1] Creekside, Inc., a Kentucky corporation wholly owned by Bollinger.

[2] Cloisters, Inc., a Kentucky corporation wholly owned equally by Bollinger and Martin.

[3] Greenland Vistas, Inc., a Delaware corporation in which petitioners had no interest.

Sometime during 1968, Bollinger sought to construct an apartment complex on a portion of land owned at the time by Beacon Hill, Inc. In order to secure the construction loan and permanent financing for the proposed development of the Creekside North Apartments, Bollinger consulted with Mr. Bryan Sumner (hereinafter Sumner), a mortgage banker in Louisville, Kentucky.[3] Bollinger was advised that financing could be obtained for real estate development projects only through a "corporate nominee." During the years in issue, Kentucky law provided that a loan made to a noncorporate borrower at a rate exceeding 7 percent per annum was usurious. During such period, the prevailing local interest rate for construction financing was over 7 percent. In order to obtain the construction loan and permanent financing, the financial institutions required that the nominal debtor be Bollinger's corporate nominee, and accordingly, record title to the property would be held by the corporate borrower. On July 24, 1968, Sumner obtained a loan commitment for permanent financing from Massachusetts Mutual Life Insurance Company (Massachusetts Mutual Life) in which Massachusetts Mutual Life agreed to loan "the corporate nominee of Jesse C. Bollinger, Jr.", $1,075,000 at an interest rate of 8 percent per annum. The loan was to be secured by a mortgage on Creekside North Apartments and by a personal guarantee of Bollinger.

[3] Bollinger would first obtain a commitment for permanent financing, in which a financial institution, usually an insurance company, agreed to loan him the anticipated cost of the project after the project was completed. The actual funds for construction were obtained from another financial institution, usually a bank, through a construction loan. When the project was completed, Bollinger would use the permanent financing to pay off the construction loan.

Bollinger, desirous to hold title in the apartment complex in his individual name, conferred with his accountant and his attorney, whereupon he was advised that the use of corporate nominees in order to obtain construction financing was common practice in the State of Kentucky. On October 14, 1968, Bollinger incorporated Creekside, Inc., under the laws of the Commonwealth of Kentucky, for the sole purpose of having a nominee corporation to secure financing for the development of his apartment projects. At all relevant times Bollinger was the sole shareholder of Creekside, Inc.

On October 15, 1968, Bollinger and Creekside, Inc., entered into an agreement which generally provided that Creekside, Inc., would hold title to the Creekside Apartment Complex as Bollinger's agent only for the purpose of securing temporary and permanent financing of the project.[4]

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[4] The nominee agreement provided in pertinent part:

WHEREAS, Bollinger proposes to construct apartments * * * in Lexington, * * * Kentucky. Said apartments to be known as Creekside Apartments * * *, and * * *

WHEREAS, Citizens Fidelity Bank & Trust Company and Massachusetts Mutual Life Insurance Company have agreed to make such a mortgage loan, but have required that the real property securing such mortgage loan be held in the name of a corporation and such mortgage loan be made in the name of a corporation in order that such loan may bear an interest rate in excess of 7% per annum, and

WHEREAS, Creekside has agreed to hold the Creekside Apartments for Bollinger as the agent and nominee of Bollinger for the sole and only purpose of securing both temporary and permanent financing of the Creekside Apartment project.

NOW, THEREFORE, in consideration of the premises and the mutual covenants and agreements hereinafter made, it is

To finance construction of the Creekside North Apartments, Bollinger, through Creekside, Inc., borrowed the funds from Citizens Fidelity Bank and Trust Company (hereinafter Citizens Fidelity). Creekside, Inc., executed all necessary loan documents including the promissory note, mortgage, and deed. Upon receipt, Creekside, Inc., transferred all loan proceeds to Bollinger's individual construction account.

Bollinger acted as general contractor during the construction of the Creekside North Apartments, and he employed Hensley on a fixed fee basis as construc-

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herein and hereby agreed by and between Bollinger and Creekside as follows:

1. Creekside will accept a deed from Beacon Hill, Inc. * * * and will immediately mortgage such property to either Citizens Fidelity Bank & Trust Co. or Massachusetts Mutual Life Insurance Company for the purpose of acquiring funds with which to pay the purchase price for such lot and construct said apartments.

2. Creekside admits and declares that it will hold such property as nominee and agent for Bollinger and will convey, assign or encumber the property and disburse the proceeds thereof and dispose of the property, any purchase money, promissory notes, mortgages and trust deeds arising out of any sale thereof as and only as Bollinger may direct in writing.

3. Creekside does not obligate itself to care for or maintain the property or to advance money on account thereof whether for taxes or otherwise or to assume any liability for payment of money by execution of promissory notes or otherwise.

4. Bollinger does, herein and hereby, agree to indemnify and hold Creekside harmless from and against any liability it may or might sustain by reason of its acting as agent and nominee for Bollinger under the terms hereof.

tion supervisor. Hensley supervised the construction, ordered materials, scheduled the work and received, reviewed, and approved all invoices. After conferring with Bollinger about construction invoices submitted for payment, costs of the construction were paid by Hensley from the construction account. On completion of the Creekside North Apartments, Bollinger, through Creekside, Inc., obtained permanent financing from Massachusetts Mutual Life in accordance with its commitment letter of July 24, 1968. This loan was secured by a mortgage upon Creekside North Apartments and by a partial personal guarantee executed by Bollinger. The loan proceeds received from Massachusetts Mutual Life were used to pay off the prior construction loan obtained from Citizens Fidelity.

During all relevant times, Bollinger intended to retain all but record title to the property and apartment complex, and he intended that the corporation would convey record title to him as soon as conveyance became feasible. Bollinger always regarded himself as the real owner of the property. On November 8, 1979, Creekside, Inc., conveyed title to the property to Bollinger.

After the Creekside North Apartments were completed, Bollinger employed Mr. John Thompson (hereinafter Thompson) as resident manager to rent the apartments, execute leases for apartment rental, collect and deposit the rent received, and maintain operating records. Thompson deposited all rental receipts into, and paid all operating expenses from, a separate operating account at Central Bank and Trust Company in Lexington, Kentucky. Although the operating account was first opened in the name of Crekeside, Inc., it was changed during 1971 to "Creekside Apartments, a partnership."

The operation of the Creekside North Apartments generated losses in the amount of $41,071.17, $7,758.14, $3,416,76, $6,815.61, and $13,342.03, for the taxable years 1969, 1971, 1972, 1973, and 1974, respectively, and generated ordinary income in the amounts of $722.62, $25,805.62, $37,285.22, and $34,511.34, for the taxable years 1970, 1975, 1976, and 1977, respectively. The income and losses generated by Creekside North Apartments were reported by Bollinger on his individual income tax returns throughout the years in issue.

Petitioners secured financing for the construction of Carriage Hill, Creekside South, Les Chateaux, Lamplighter, Two Lakes, Ski Lodge, and Cloister Apartments through the use of a corporate nominee. In each case, the pattern was substantially identical to the development of the Creekside North Apartments. For each of the respective apartment complexes the financial institution required that the construction loans and permanent financing be made to a corporate nominee with at least a partial personal guarantee by the partners; the partnerships executed nominee agreements, which were similar in all relevant respect to the agreement set forth in note 4, *supra*, with the corporation for the sole purpose of obtaining the financing; and the corporation transferred the construction loan proceeds upon receipt to the partnership's construction account from which all invoices were paid by the construction supervisor hired by the partnership.

Upon completion of each of the respective apartment complexes, the corporate nominee secured permanent financing which was used to pay off the construction loan. Each partnership actively managed its respective apartment complex depositing all rental

receipts into, and paying all expenses from, a separate partnership account. Income and losses generated by each of the apartment complexes, except Ski Lodge, were reported by the respective partnerships on U.S. Partnership returns (Form 1065) filed for the years in issue. Petitioners in turn reported their distributive share of the partnership income and losses on their individual income tax returns filed during the years in issue. Bollinger reported the income and losses generated by Ski Lodge Apartments, a sole proprietorship, on his individual income tax returns.

At all relevant times, Bollinger, or the respective partnership, intended to retain all but record title to the apartment complexes. They always regarded themselves as the real owners of the property. It was only because the financial institutions would not provide either a partnership or an individual a construction loan or permanent financing for development of the projects that record title to the property was held by a nominee corporation, either Creekside, Inc., or Cloisters, Inc. In fact, in all loan commitment letters, except the one for Cloister Apartments, the financial institution required that the loan be made to the corporate nominee of Jesse C. Bollinger.

Creekside, Inc., acted as corporate nominee for the Carriage Hill, Creekside South, Les Chateaux, Lamplighter, Two Lakes, and Ski Lodge Apartments. Cloisters, Inc., acted as the corporate nominee for Cloister Apartment partnership. In order to secure the financing, Creekside, Inc., or Cloisters, Inc., as an agent for the respective partnership pursuant to the nominee agreement, signed the loan agreements, mortgages, deeds, and promissory notes in order to obtain the needed financing. At all relevant times,

the lenders regarded Bollinger, or the respective partnership, as the owners of the apartment complexes. Financial institutions required partial personal guarantees from the partners and looked to them for repayment.

During the years in issue, Creekside, Inc., and Cloisters, Inc., had no liabilities, assets, employees, or bank accounts; nor did they manage the apartment complexes once the buildings were placed into service.

In the statutory notices of deficiency, respondent disallowed the partners' claimed loss deductions determining that the partnership was not entitled to deduct expenses incurred during the construction, leasing, and operating of the various apartment complexes.[5] Respondent determined that such losses were those of the corporation which held record title to the real estate, either Creekside, Inc., or Cloisters, Inc.

OPINION

The sole issue for decision is whether the losses incurred by the construction and operation of the apartment complexes are attributable to the corporation or to the individual partners in the partnership. Petitioner argues that the corporation acted solely as an agent of the partnership, holding record title to the properties and obtaining project financing on behalf of the partnership only because of local usury restrictions. Thus, petitioners conclude that the partnership, as the principal, is the entity which is re-

[5] We note that in the statutory notice, respondent maintained inconsistent positions with respect to the partnerships; he disallowed the loss deduction to the partners when the partnerships generated losses, but attributed the income to the partners in the latter years when most of the partnerships generated income.

sponsible for the tax consequences of the construction project. On the other hand, respondent maintains that there is no agency relationship recognized for tax purposes between the corporation and the partnership and that the losses generated by the projects are properly attributable to the corporation.

We have carefully considered the issue of whether a corporation will be treated as a nontaxable agent for a partnership in *Roccaforte v. Commissioner*, 77 T.C. 263 (1981), rev'd, 708 F. 2d 986 (5th Cir. 1983), and *Ourisman v. Commissioner*, 82 T.C. 171 (1984), both Court Reviewed Opinions. In *Roccaforte*, the taxpayers formed a partnership to build and operate an apartment complex. As in the present case, in order to secure financing for the projects, the lenders required that the nominal borrower be a corporation in order to avoid the state usury limitations. The partners formed a corporation and executed an agreement providing that the corporation was to act only as an agent for the partnership to obtain financing, that the partners remained the owners of the realty, and that the corporation would act only upon the authorization of the partners. The agreement further provided that the partners would hold the corporation harmless for all acts and debts related to the apartment complex. The corporation acquired record title to realty and executed the document necessary to obtain both the construction and the permanent loans. Several of the partners personally guaranteed the loans. The corporate creditors were all aware that the corporation represented the partnership. The corporation supervised the construction and maintained a checking account into which it deposited the loan advances and from which it made interest and progress payments. The corporation had no assets, liabilities, income, or expenses; nor did it

manage the apartment complex once the building was placed in service.

In *Roccaforte*, we decided that in *National Carbide Corporation v. Commissioner*, 336 U.S. 422, 437 (1949), the Supreme Court established the following six factors to be considered in determining whether a true corporate agency relationship exists: (1) whether the corporation operates in the name and for the account of the partnership; (2) whether the principal is bound by the corporate-agent's actions; (3) whether the corporate-agent transmitted the money received to the partnership; (4) whether receipt of income is attributable to the assets or employees of the partnership; (5) whether the corporate-agent's relationship with the partnership was dependent on the fact that it was owned and controlled by the partners; and (6) whether the corporation's activities were consistent with the normal duties of an agent. No one factor is mandatory and absolute.[6]

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[6] In *Roccaforte v. Commissioner*, 77 T.C. 263 (1981), revd. 708 F.2d 986 (5th Cir. 1983), the Fifth Circuit reversed the finding of the Tax Court and held that the fifth factor is mandatory and absolute. 708 F.2d at 989. However, in *Ourisman v. Commissoner*, 82 T.C. 171 (1984), we disagreed with the Fifth Circuit's interpretation of *National Carbide v. Commissioner*, 336 U.S. 422 (1949), and decided to continue to follow our decision in *Roccaforte*. Since appeal of the instant case lies to other than the Fifth Circuit, we are not required to follow the Fifth Circuit's decision in *Roccaforte*. *Golsen v. Commissioner*, 54 T.C. 742 (1970), affd. 445 F.2d 985 (10th Cir. 1971). We note, however, that the Fifth Circuit concluded, in a situation where the same parties did not own a controlling interest in both the partnership and the corporation, that the purported principal, the partnership, was in fact not the owner of the purported corporate agent. See *Moucrief v. United States*, 730 F.2d 276 (5th Cir. 1984).

In *Ourisman* we reiterated our position that a corporation may, under the proper facts and circumstances, be considered as a true agent of the partnership. In *Ourisman*, the partnership wished to construct an office building. As in the present case, the usury laws prevented financial institutions from loaning the money directly to the individuals or the partnership. In order to obtain the financing, the lender required that the nominal debtor be the corporate nominee of the partnership, and accordingly, record title to the leasehold was held by the corporate nominee. The corporation executed the loan agreements as well as the promissory note and the deed of trust. The partners personally guaranteed payment of the construction loan and the partners always regarded themselves as the real owners of the property. As in the present case, the corporation never opened a bank account, loan proceeds were transferred to the partnership, the partnership made all interest and principal payments on the notes, the partnership operated and maintained the buildings, and the partnership reported the income and losses from the operation of the buildings. In *Ourisman*, applying the indicia of agency specified in *National Carbide* as we interpreted them in *Roccaforte*, we held that:

> [T]he present case compels the conclusion that the corporation acted as the partnership's agent in the construction and operation of the office building. The corporation acted in the name and for the account of the partnership. The corporation was created at the insistence of the construction lender, which required that the loan be made to the corporate nominee of the partnership. • • • The agreement with the partnership also provided that the corporation would acquire the leasehold, obtain the necessary financing, and erect an office building solely as the nominee of the partnership, which would remain the corporation's principal and the true owner of the leasehold and improvements. [*Ourisman v. Commissioner*, *supra* at 181, 182.]

The present case is indistinguishable from *Roccaforte* and *Ourisman*, and the facts before us compel the same conclusion reached therein, that is, the partnerships, and not the corporations, were the owners of the apartment complexes for Federal income tax purposes.

Creekside, Inc. and Cloisters, Inc., operated in the name of, and for the account of, the partnerships it represented. For each apartment project, the corporations entered into a separate nominee agreement with the partnership. Pursuant to the agreement, the corporations were not authorized to act except at the direction of the partnership. Further, the corporations never represented themselves as anything more than an agent of the partnership. Most lenders also required the partners to personally guarantee a portion of the loans needed for various projects. This indicates that throughout the years in issue, Creekside, Inc., and Cloisters, Inc., were acting as an agent for the underlying partnership. Indeed, the banks and financial institutions were well aware that the corporations were merely a shell. In fact, the lenders would not have lent the money directly to the individuals or the partnership because of usury laws and made most of the loan commitments to the corporate nominee of Jesse C. Bollinger.

The corporations also bound the partnerships by their actions. Project creditors were all well aware

that the corporations were acting for the partnership. The nominee agreements provided that the partnerships remain the real party in interest with respect to the projects. The partnerships agreed to indemnify and hold harmless the corporation for any liability it might sustain by reason of acting as an agent for the partnerships. The corporations were not obligated to care for or maintain the property. Finally, the partnership made all principal and interest payments on the loan and paid all other expenses associated with the apartment complexes.

The third factor specified by the Supreme Court in *National Carbide* is whether the corporation transmitted receipts to the partnerships. The only funds which passed to the corporations were the construction and permanent loan advances which the corporation would immediately endorse and forward to the partnership. Rental receipts and expenses were collected by the partnership and deposited immediately in partnership accounts.

The fourth factor is whether the income received from the apartment complexes was attributable to the employees and the assets of the partnerships. At no time throughout the years in issue did either Creekside, Inc., or Cloisters, Inc., have any employees or hire any one to act on its behalf. Moreover, neither corporation had any assets beyond record title to the various apartment projects and, as soon as practical, the corporations conveyed title to the partnerships. At all relevant times, the partners believed themselves to be, and acted as, the owners of the apartment complexes. The partnerships hired the agents, performed the activities necessary to arrange for construction and operation of the apartment complexes, executed contracts, leases, and paid the costs

of constructing and operating the apartment complexes. The partners located the land and coordinated all the activities concerning construction of the apartment complexes. The corporation's only activity consisted of holding record title, executing the necessary loan documents, and endorsing loan advances to the partnerships. On this record we must conclude, as we did in *Ourisman* and *Roccaforte*, that the income realized from the buildings was attributable to the efforts and the assets of the partners.

The fifth factor is whether the corporate-agent's relationship with the partners was dependent on the fact that it was owned and controlled by the partners. In the instant case, Creekside, Inc., acted as an agent for seven partnerships: Creekside North; Carriage Hill; Creekside South; Les Chateaux; Lamplighter; Two Lakes; and Ski Lodge. Although Bollinger owned 100 percent of the stock of Creekside, Inc., with the exception of the Creekside North Apartments and Ski Lodge Apartments, Bollinger did not have a 100 percent interest in all the partnerships. Bollinger had a 66⅔ percent interest in the Carriage Hill partnership; a 50 percent interest in Creekside South and Two Lakes partnerships; and a 33⅓ percent interest in Les Chateaux and Lamplighter partnerships. Thus, the facts before us are stronger than *Roccaforte* and *Ourisman*, where the corporations were controlled and dominated by the identical individuals who were investors in the partnerships.[7] Although Creekside, Inc., was not com-

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[7] See *Monerief v. United States*, 730 F.2d 276 (5th Cir. 1984) (On similar facts, the court upheld the jury's decision that the corporation acted as a true agent of the partnership because the corporate stock was held entirely by an individual

pensated for the services it performed, because in at least five developments the partners did not own the stock of the corporation in the same percentage as their partnership interest, we believe that the agency relationship was not based upon the partners' ownership and control of both entities. See *Raphan v. United States*, 3 Cl. Ct. 457 (1983). With respect to Cloisters, Inc., in which the partners' ownership and control of both entities was in the same proportion, we must conclude that the corporate-agent's relationship with the partnership was dependent on the fact of common ownership and control. However, Cloisters, Inc., like Creekside, Inc., was acting as an agent for the partnership because it carried on only negligible activities, all persons dealing with it were aware it was acting as an agent, and the substantial activities involved in constructing and operating the building were performed by the partners. Since the corporations acted no differently than independent agents, they should be recognized for tax purposes as such. *Ourisman v. Commissioner*, *supra* at 187. See *Raphan v. United States*, *supra* at 463 ("Moreover, the narrow purpose of the agency agreement—holding nominal title to avoid usury problems —could have been performed equally well by a corporation unrelated to any of the parties.")

The final *National Carbide* factor is whether the corporation's activities were consistent with the normal duties of an agent. Both corporations, Creekside, Inc., and Cloisters, Inc., acted as an agent for the partnerships. The corporations executed a nominee agreement with each of the partnerships whereby

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who only had a 25 percent interest in the partnership and thus the partnership was in fact not the owner of the purported corporate agent.)

Creekside, Inc. and Cloisters, Inc., agreed to hold title to the property for the sole purpose of obtaining financing for the construction of the apartments. Pursuant to that agreement the corporations executed the necessary documents to secure both temporary and permanent financing for the partnerships' projects. The lenders were all fully aware that the corporations were acting as an agent of the partnerships and merely holding legal title to the property in order to satisfy the lenders' financing requirements. The corporations did not act in any manner which could be interpreted as an assertion of principalship.

On this record we must conclude, as we did in *Roccaforte* and *Ourisman*, that petitioners have clearly established that the corporations were acting as the partnerships' agent in the construction and operation of the various apartment complexes. What we stated in *Roccaforte* is equally applicable herein:

> We are convinced that the investors desired to operate in partnership form and were forced to form a corporation to comply with the State's usury laws. The partners did not attempt to avail themselves of the normal benefits of the corporate form such as limited liability. Rather, the partners remained subject to the claims of creditors and to all other claims arising out of the apartment project.
>
> We believe that the entire substance of the arrangement was one of an agency relationship, and even the form (outside of the corporation's primary liability on the mortgages) indicated the agency relationship that was intended. We are not presented here with the use of a corporation as a tax-avoidance scheme. Rather, the

partners were forced to form a corporation in order to get financing for their project. They sought none of the traditional insulating benefits of a corporate shareholder. In substance, the partners were the true economic owners of the property with all the risks and benefits attendant thereto. In such cases, where the corporation was formed solely to satisfy the requirement of the bank in complying with State usury laws and the indicia of an agency relationship are present, we will respect the status of the corporation as an agent of the partnership. [77 T.C. at 278-288 (fn. ref. omitted), cited in *Ourisman v. Commissioner*, *supra* at 184.]

To reflect the foregoing and concessions by the parties,

Decisions will be entered under Rule 155.

OPPOSITION

BRIEF

No. 86-1672

In The
Supreme Court of the United States
October Term, 1986

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

JESSE C. BOLLINGER, JR., *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the income and losses generated by the construction and operation of various apartment complexes are attributable to the proprietorship or partnership which owned, constructed and operated the particular apartment complex or to the nominee corporation created to act as agent to hold record title to the property for the purpose of obtaining construction and permanent financing.

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STATEMENT OF THE CASE

1. Introduction.

This case involves proposed deficiencies in federal income taxes. The tax years involved and the deficiencies proposed against the respondents are listed in the opinion of the Tax Court and appear at page 15a of the appendix ("Pet. App.") to the petitioner's brief ("Pet. Br.").

The petitioner has misstated the issue in this case. The respondents have never argued that the nominee corporations should be disregarded for federal income tax purposes. The respondents have consistently argued that the nominee corporations were viable entities. Only viable corporations could have served as agents. The respondents argue that the nominee corporations, although separate entities, acted only as a nominee or agent with respect to the particular apartment complexes and, therefore, that the tax attributes arising from the ownership, construction and operation of the apartment complexes accrue to the principal.

2. Statement of Facts.

The respondent, Jesse C. Bollinger, Jr. ("Mr. Bollinger"), was a real estate developer who, both individually and in partnership with others, developed eight (8) apartment complexes in Kentucky. The other respondents (exclusive of their respective wives) were partners in some, but not all, of those ventures. The apartment complexes and the proprietorship or partnership applicable to the particular apartment complex are listed in the Sixth Circuit's opinion in the pending case. (Pet. App., 2a-3a n. 1).

During the years at issue, Kentucky law provided that a loan made to a noncorporate borrower at a rate exceeding 7% per annum was usurious. During such period, the prevailing local interest rate for construction and permanent financing exceeded 7%. In order for the proprietorship and partnerships to obtain construction and permanent financing, the financial institutions required that the nominal debtor be Mr. Bollinger's corporate nominee, and accordingly, record title to the various apartment complexes was held by a nominee corporation as a device to comply with Kentucky law. (Pet. App. 2a, 17a, 19a).

Mr. Bollinger formed the Kentucky corporation named Creekside, Inc. for the sole purpose of having a corporate nominee for securing financing for the development of seven (7) of the apartment complexes. Mr. Bollinger was the sole shareholder of Creekside, Inc. (Pet. App., 3a, 5a). Cloisters, Inc. (which was owned equally by Mr. Bollinger and another investor) was the nominee corporation for the other apartment complex. (Pet. App., 5a). Each proprietorships and partnerships entered into an agreement with the nominee corporation for the particular apartment project. The agreements provided, generally, that (a) the nominee corporation would hold title to the apartment property as nominee and agent for the proprietorship or partnership for the sole purpose of securing temporary and permanent financing of the apartment project, (b) the nominee corporation had no obligation to care for or maintain the property or advance money on account thereof or to assume any liability for payment of money by execution of promissory notes or otherwise and (c) the proprietorship or partnership would indemnify and hold harmless the nominee corporation from and against any liability it may or might sustain by reason of its action as nominee and agent for the proprietorship or partnership. (Pet. App., 3a-5a, 20a n.4, 30a-31a).

All the apartment complexes were construced and operated in substantially the same manner. The applicable proprietorship or partnership, through the corporate nom-

inee, would borrow construction funds from a lender, with the nominee corporation executing all the loan documents and then transferring the loan proceeds to the proprietorship or partnership. The proprietorship or partnership would construct the apartment complex, with the cost of construction paid from a construction account of the proprietorship or partnership. Upon completion of the apartment complex, the proprietorship or partnership, through the corporate nominee, would obtain permanent financing from a lender, with the loan being secured by a mortgage upon the apartment complex and a partial personal guarantee from the proprietor or partners, as applicable. The applicable proprietorship or partnership employed resident managers to rent the apartments, execute leases, collect rents and maintain operating records. (Pet. App., 4a-5a).

The various lenders regarded the proprietor (Mr. Bollinger) and the respective partnerships as the owners of the various apartment complexes, required partial personal guarantees from the proprietor or partner and looked to them for repayment. (Pet. App., 5a, 24a-25a).

Creekside, Inc. and Cloisters, Inc. had no liabilities, assets, employees or bank accounts, nor did either corporation manage the apartment complexes. (Pet. App. 5a).

The income and losses of the proprietorships were reported by Mr. Bollinger for federal income tax purposes. Each partnership reported its income or losses on its partnership return, and each respondent reported his distributive share of the partnership's income and losses on his federal income tax return. (Pet. App., 4a-5a, 23a-24a).

The respondents desired to operate their businesses either as sole proprietorships or partnerships, as applicable, and were thwarted in completely doing so only by the practicable requirements that they form corporations in order to comply with the Kentucky usury laws. They did not attempt to avail themselves of the normal benefits of doing business in the corporate form. They conducted the businesses in their individual and partnership capacities and thereby remained subject to the claims of creditors and others. They did not use the corporations as part of a tax avoidance scheme. (Pet. App., 4a, 8a, 33a).

The petitioner maintained inconsistent positions with respect to the proprietorships and partnerships. In his statutory notices, the petitioner disallowed the loss deductions claimed by the respondents when the apartment complexes generated losses and attributed the losses to the nominee corporation which held title to the apartment complex property. In the later years when most of the apartment complexes generated income, the petitioner attributed the income to the respondents. (Pet. App., 5a, 25a, n.5). The petitioner, therefore, refused to recognize the agency relationships when the apartment complexes were generating losses and recognized the agency relationships when the apartment complexes were generating income. The respondents, however, consistently reported their income and losses from the proprietorships and partnerships. (Pet. App., 4a-5a, 23a-24a).

3. Proceedings Below.

After concessions by the parties, the sole issue presented for decision by the Tax Court was whether the in-

come and losses generated by the ownership, construction and operation of the various apartment complexes were attributable to the proprietorships and partnerships which constructed and operated the apartment complex or to the corporation created to act as agent for the proprietorship or partnership for the limited purpose of complying with the Kentucky usury laws. (Pet. App., 15a-16a). The Tax Court held that the respondents clearly established that the corporations were acting as nontaxable agents and that the income and losses from the ownership, construction and operation of the apartment complexes were attributable to the applicable proprietorship or partnership. (Pet. App. 5a, 14a-34.).

The petitioner filed a notice of appeal to the Sixth Circuit, which court affirmed the decision of the Tax Court. (Pet. App., 1a-11a). In affirming, the Sixth Circuit was guided, in part, by the Supreme Court's analysis in *National Carbide Corp. v. Commissioner*, 336 U.S. 422 (1949) of the characteristics of a true agency relationship. In *National Carbide*, the Supreme Court recognized that a true corporate agent or trustee can handle the property and income of its owner-principal without being taxable therefor. (336 U.S. at 437). After discussing four characteristics normally found in a true agency relationship, the Supreme Court in *National Carbide* stated as follows (*supra* at 437):

> " . . . If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that that it is owned by the principal, if such is the case."

The Sixth Circuit, like the Tax Court, found *National Carbide* to be instructive and concluded that the *National Carbide* requirements are satisfied ". . . when the evidence establishes that the attributes of an agency are present, and the corporate nominee conducts itself no differently than would an independent agent which had bargained with its principal for its services at arm's length . . . ". (Pet. App., 9a-10a). Based upon this premise, the Sixth Circuit affirmed the Tax Court's conclusion that the nominee corporations (Creekside, Inc. and Cloisters, Inc.) were nontaxable agents. (Pet. App., 1a-11a).

4. The Petition.

The respondent petitioned for a writ of certiorari on the theory that the opinion of the Sixth Circuit in the pending case conflicts with (a) the opinions of the Fourth Circuit in *Ourisman v. Commissioner*, 760 F.2d 541 (4th Cir. 1985) and *Frink v. Commissioner*, 798 F.2d 106 (4th Cir. 1986), petition for cert. pending, No. 86-1151 and (b) the opinions of the Fifth Circuit in *Roccaforte v. Commissioner*, 708 F.2d 986 (5th Cir., 1983) and *George v. Commissioner*, 803 F.2d 144 (5th Cir. 1986), petition for cert. pending, No. 86-1152. Each of said decisions relied, in part, upon *National Carbide*. The *Frink* and *George* cases arise out of the same transaction and were consolidated for decision in the Tax Court, but appeals went to different courts of appeals.

The petitioner attempts to support its petition by reference to arguments contained in its consolidated brief ("Consol. Br.") filed in the *Frink* and *George* cases. The petitioner argues that a controlled corporation can serve as agent for its owner-principal " . . . only where the shareholders establish that the agency relationship is unaffected

by the ownership situation, *and* that the corporation as 'agent' is in fact acting at arm's length with its shareholders as 'principal' ". (emphasis added; Consol. Br., p. 11). The petitioner's analysis is flawed because an agent cannot, in fact, act at arm's length with its owner-principal.

REASONS FOR NOT GRANTING THE PETITION

The petition for certiorari should not be granted for the following reasons:

1. There are substantial variations between the factual situations in the pending case and the factual situations in *Ourisman v. Commissioner, supra; Frink v. Commissioner, supra; Roccaforte v. Commissioner, supra,* and *George v. Commissioner, supra,* which variations place in issue whether there is in fact a conflict between the Sixth Circuit and either the Fourth Circuit or Fifth Circuit.

2. The issue is no longer of sufficient importance to justify consideration by the Supreme Court.

The factual situation in the pending case is unique among the reported cases involving the use of a corporate agent to hold title to real property for its principal for the sole purpose of obtaining construction and permanent financing for improvements to be constructed on the property. In *Ourisman, Frink, Roccaforte* and *George,* the purported agent acted only for one principal. In the pending case, the nominee corporation, Creekside, Inc., was wholly owned by Mr. Bollinger and not only acted as agent for Mr. Bollinger, individually, but also acted as agent for

several partnerships in which Mr. Bollinger had partnership interests varying from 66⅔ percent (Carriage Hill Partnership) to 33⅓ percent (Les Chateaux Partnership and Lamplighter Partnership). (Pet. App., 2a-3a n.1). With respect to this factual variation, the Tax Court stated in the pending case as follows (Pet. App., 31a):

> . . . Thus, the facts before us are stronger than *Roccaforte* and *Ourisman*, where the corporations were controlled and dominated by the identical individuals who were investors in the partnerships.

The petitioner has failed to establish that the opinions of the Fifth Circuit in *Roccaforte* and *George* conflict with the opinion of the Sixth Circuit in the pending case. In *Roccaforte* the purported corporate agent was initially wholly owned by the partners in the purported principal. In subsequent years, three individuals purchased a combined 10% partnership interest in the purported principal and no interest in the purported agent. The purported agent was used to comply with state usury laws and did not serve as agent for any other principal. The Fifth Circuit held against the taxpayers and, in so holding, stated, in part, as follows (*supra*, at 990):

> . . . To prevent abuse, the taxpayer should be required to show more than those agency attributes that arise naturally from ownership and control of the corporation—he should be required to show that an agency relationship could exist independently of such ownership and control. This is precisely what the mandatory fifth condition of *National Carbide* requires.

In *George*, the Fifth Circuit stated, in part, as follows (*supra*, at 148):

> . . . When the relationship between a putative agent and its principal depends on the principal's ownership of the agent, the tax law will not accept the putative agency relationship.
>
> Taxpayers may satisfy the independence requirement by showing either that the principal did not own the agent or that the agency relationship did not depend on such ownership.

The Fifth Circuit found in *George* that the principal controlled the agent through ownership and that the taxpayers failed to prove that the agency relationship did not depend on such ownership. (*supra*, at 148-149).

If the purported agent is owned and controlled by the purported principal, then the Fifth Circuit requires the taxpayer to offer sufficient proof ". . . to show that an agency relationship could exist independent of such ownership and control." *Roccaforte v. Commissioner*, *supra*, at 990. This standard is not inconsistent with the standard expressed by either the Supreme Court in *National Carbide* or the Sixth Circuit in the pending case. The taxpayers in *Roccaforte* and *George*, unlike the taxpayers in the pending case, simply failed to convince the Fifth Circuit that the agency relationship could exist independently of any ownership and control by the principal.

There is a greater appearance of a conflict between the opinions of the Fourth Circuit in *Ourisman* and *Frink* and the opinion of the Sixth Circuit in the pending case because of an inconsistency in approach by the Fourth Circuit. In *Ourisman* the Fourth Circuit stated that if the purported principal owns and controls the purported agent, then the nontaxable status of the agent will be recognized only ". . . if it can be shown that the agency relationship

reflects an arm's length arrangement between the principal and agent." *Ourisman v. Commissioner*, *supra*, at 548. The "reflect" concept appears to be generally consistent with the opinion of the Supreme Court in *National Carbide* and the opinion of the Sixth Circuit in the pending case. The Fourth Circuit, however, analyzed the facts in *Ourisman* not to determine if the relationship "reflects an arms-length arrangement", but to determine if the relationship ". . . was in fact an arm's length arrangement . . ." (*supra*, at 548). The Fourth Circuit found against the taxpayer in *Ourisman* by concluding ". . . that the corporation and the partnership did not bargain at arm's length" (*supra*, at 548) and continued by stating as follows (*supra*, at 548):

> . . . Such a result simply recognizes the fact that if the agency relationship could not exist but for the shareholders' ownership and control of the corporate agent, the alleged agency relationship is nothing more than a manifestation of the underlying corporation-shareholder relationship and that the corporation therefore must be regarded as a separate taxpaying entity under our system of separate taxation of corporations.

In *Frink*, the purported corporate agent was owned 50% by Mr. Yemelos and 50% by his wife. Mr. Yemelos owned the majority partnership interest in the purported principal. The purported agent was used to comply with state usury laws and did not serve as agent for any other principal. Based upon *Ourisman*, the Fourth Circuit found against the taxpayers in *Frink*.

Although it cannot be stated with certainty, it appears that the taxpayers in *Ourisman* and *Frink* were unsuccessful for basically the same reasons that the taxpayers in *Roccaforte* and *George* were unsuccessful, namely—they

failed to satisfy the reviewing court that the agency relationship could exist independently of the principal's ownership and control of the agent.

With respect to the Fourth Circuit's analysis in *Ourisman*, the Sixth Circuit in the pending case stated as follows (Pet. App., 10a-11a):

> In our view, when the evidence establishes that the attributes of an agency are present, and the corporate nominee conducts itself no differently than would an independent agent which had bargained with its principal for its services at arm's length, then, even under the Fourth Circuit's "but for" test, a true principal-agent relationship has been proved. When the Supreme Court, in *National Carbide*, said that, under certain circumstances, a true corporate agent is not foreclosed from handling the property and income of its owner-principal without being taxable, it could not have contemplated so strict a reading of circumstances that, as a practical matter, the existence of a true agency would be foreclosed. What the Supreme Court demanded was an inquiry into the actual substance of the relationship to determine if an agency existed in fact. Here, by any realistic assessment, the corporations acted like agents. . . . Accordingly, we decline to follow the Fourth Circuit's view, as expressed in *Ourisman*.

The pending case does not involve the tax avoidance or manipulation that was involved in *National Carbide*. That case involved an arrangement, formalized by an "agency" agreement, whereby a parent corporation utilized its wholly owned subsidiaries as operating companies to manufacture and sell goods. Under the "agency" agreement, the parent corporation provided executive management, capital and office facilities to the subsidiary corporations and the latter agreed to pay substantially all

the profits from their manufacturing and sales operations to the parent corporation. The subsidiary corporations were the actual owners of their operating assets and actually used those assets to generate the income in question. The purpose of the agency contracts was to prevent vesting of the income in the subsidiary corporations and to vest the income in the parent corporation. The Supreme Court concluded that the "agency" agreements added nothing to the relationship and that the agreements could be disregarded so that the tax consequences might follow the reality of the circumstances.

The pending case does not involve the use of agency agreements to anticipatively prevent the vesting of income otherwise earned. In the pending case, the respondents rely upon agency agreements primarily for the purpose of establishing the true and beneficial ownership of the income producing assets.

In *Raphan v. United States*, 3 Cl. Ct. 457, 463 (1983), aff'd 759 F.2d 879 (Fed. Cir. 1985), cert. denied 106 S.Ct. 129 (1985), the Claims Court stated that ". . . the narrow purpose of the agency agreement—holding nominal title to avoid usury problems—could have been performed equally well by a corporation unrelated to any of the parties." For some reason the Fourth Circuit in *Ourisman* and *Frink* and the Fifth Circuit in *Roccaforte* and *George* either failed to or refused to recognize this fact in considering circumstances in which the purported principal had ownership control of the purported agent. The Fifth Circuit's position is particularly distressing because of that Circuit's recognition in *Moncrief v. United States*, 730 F.2d 276 (5th Cir. 1984) that a corporation can act as a nontaxable

agent for the purpose of holding nominal title to avoid usury problems. Nevertheless, under the facts of *Ourisman*, *Frink*, *Roccaforte* and *George*, the taxpayers were not able to establish that the purported agent ever served as agent for anyone other than its owner-principal. In the pending case, the number of agencies involved and the variations in ownership unequivocally establish that the agent did, in fact, serve as agent for principals who did not control it through ownership interest. The control came through the agency agreements, which agreements reflected the substance of the transactions. Without these agreements, the respondents, other than Mr. Bollinger, could not have protested their respective interest in the various apartment complexes. For this reason, it cannot be concluded with any degree of certainty that either the Fourth Circuit or the Fifth Circuit would hold against the taxpayers if presented with the same factual situation as exists in the pending case.

If there is in fact a conflict between the circuits, the issue is no longer of sufficient importance to justify consideration by the Supreme Court. The petitioner seems to recognize this fact with respect to the use of agents to comply with usury laws (Consol. Br., 15-16) but argues that the "agency" issue ". . . is likely to continue to arise in the future, whenever the choice of the corporate form for business purposes proves to be disadvantageous from a tax standpoint." (Consol. Br., 16). Supreme Court review of the pending case for the reasons stated by the petitioner would be of little, if any, assistance because both the Tax Court (Pet. App., 33a) and the Sixth Circuit (Pet. App., 4a, 8a) concluded that the agency relationships were not tax avoidance schemes.

The petitioner has requested, in the event certiorari is granted in *Frink* and *George*, that this case be held pending disposition of the *Frink* and *George* cases. Due to the substantial variation between the factual situation in the pending case and the factual situation in *Frink* and *George*, it is appropriate for this Court to deny certiorari in the pending case even if certiorari is granted in *Frink* and *George*. It would not be appropriate under any circumstances to hold this case pending the disposition of *Frink* and *George*.

CONCLUSION

The petition for writ of certiorari should not be granted.

Respectfully submitted,

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PETITIONER'S

BRIEF

(3)

No. 86-1672

In the Supreme Court of the United States

OCTOBER TERM, 1987

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JESSE C. BOLLINGER, JR., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Whether a corporation formed by the controlling members of a real estate partnership or proprietorship to hold title to property, and to obtain financing that the partnership or proprietorship itself could not obtain, can be disregarded for federal income tax purposes on the ground that it is merely an "agent" of the partnership or proprietorship.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Edward H. Peter, Jr., Mary H. Peter, Paul W. Hensley, Mary N. Hensley, Suz-Anne C. Bollinger, and Jacqueline Bollinger were also petitioners in the Tax Court and are respondents here.

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-11a) is reported at 807 F.2d 65. The memorandum opinion of the Tax Court (Pet. App. 14a-34a) is reported at 48 T.C.M. (CCH) 1443.

JURISDICTION

The judgment of the court of appeals (Pet. App. 12a-13a) was entered on December 2, 1986. On February 19, 1987, Justice O'Connor extended the time for filing a petition for a writ of certiorari to and including April 16, 1987. The petition was filed on that date and was granted on June 8, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Respondent Jesse C. Bollinger, Jr., was a real estate developer. Individually and in partnership with others, he constructed eight apartment complexes in Kentucky. Two of the complexes were developed by Bollinger as a sole proprietor. The other six were developed by six partnerships that Bollinger caused to be formed and of which he was a member. Bollinger's beneficial interests in the partnerships ranged variously from 33⅓% to 66⅔% between 1968 and 1974; his interest in two of the partnerships declined thereafter. Pet. App. 18a. The other respondents were partners in one or more of the partnerships.[1]

Construction financing was not available to Bollinger or the partnerships directly because the market interest rate at the time exceeded the maximum rate (7%) that could be charged to noncorporate borrowers under Kentucky's usury law. The usury restriction, however, did not apply to corporate borrowers. To avoid the usury problem, a pair of corporations were used to borrow the funds for development and to hold title to the properties. Bollinger formed a Kentucky corporation named Creekside, Inc. (Creekside), of which he was the sole stockholder, to act as the borrower and title-holder for his two sole proprietorships and for five of the partnerships. Cloisters, Inc. (Cloisters), a Kentucky corporation in which Bollinger and George Martin each

[1] A chart detailing the various ownership interests is included in the opinion of the Tax Court (Pet. App. 18a) and of the court of appeals (*id.* at 2a-3a n.1). For purposes of simplicity, we will sometimes use the term "partnership," as did the Tax Court (*id.* at 17a n.2), to refer not only to the six partnerships but also to the two sole proprietorships.

held a 50% interest, acted as the borrower and title-holder for the sixth partnership, in which Bollinger and Martin each likewise held a 50% interest. Pet. App. 2a-4a.

Each partnership entered into a side agreement with the corporation to which title to the real estate had been transferred. These agreements provided that the corporation would hold title to the property as agent of the partnership for the sole purpose of securing financing. No provision was made in any of the agreements for payment of a fee to the corporation for its services, and no such fee was ever paid to either corporation. Pet. App. 20a, 31a-32a.

In each instance, the corporation executed the loan documents, and the loans were secured by the real estate titled in the corporation's name. None of the loan documents indicated that the corporate borrower was acting as the agent of another party. Bollinger and his partners personally guaranteed the loans, and each partnership agreed to indemnify the corporation for any liabilities arising in the course of its duties. Bollinger or the partnerships acted as general contractor during the construction of the apartment complexes, and the partnerships employed resident managers to operate the complexes. Pet. App. 4a-5a, 20a & n.4, 21a-25a.

For each of the tax years at issue (ranging variously from 1969 to 1977), Bollinger reported on his personal tax return the expenses incurred and receipts generated in constructing and operating the two apartment complexes as to which he acted as sole proprietor. The partnerships reported on their partnership tax returns the expenses incurred and receipts generated in constructing and operating the six other complexes. Bollinger and the other respond-

ents in turn claimed their distributive shares of those partnership expenses as loss deductions on their personal tax returns. Pet. App. 23a-24a.

On audit, the Commissioner disallowed the deductions claimed by respondents. He took the position that the interest paid on the mortgage notes and the other expenses relating to the properties were incurred by the respective corporations that borrowed the money and held title to the realty, not by Bollinger personally or by the partnerships.[2] The Commissioner therefore determined that the expenses were deductible by the corporations, and not by respondents. Pet. App. 5a.

2. Respondents sought redetermination of the deficiencies in the Tax Court. Relying on an inference drawn from this Court's decision in *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422 (1949), the Tax Court held that the two corporations formed and used to obtain financing were the mere "agents" of the partnerships or proprietorships that they served. The court therefore concluded that the corporations could be disregarded for tax purposes and that Bollinger and his partners were the proper persons to report the interest deductions and the other expenses at issue. Pet. App. 14a-34a. In so holding, the Tax Court relied (*id.* at 26a-31a) on its prior reviewed decisions in *Roccaforte* v. *Commissioner*, 77 T.C. 263 (1981), rev'd, 708 F.2d 986 (5th Cir. 1983), and *Ourisman* v. *Commissioner*, 82 T.C. 171 (1984), rev'd, 760 F.2d 541 (4th Cir. 1985).

[2] The Tax Court noted (Pet. App. 25a n.5) that the Commissioner had maintained "inconsistent positions" in the statutory notices of deficiency in that he disallowed the partners' loss deductions, but did not disturb the attribution of the income to the partners in the years when the apartments generated income. These positions were taken purely as a protective matter to preserve the public fisc regardless of the result reached in the Tax Court. The Commissioner never suggested that the loss deductions had to be attributed to the corporation *and* that the income had to be attributed to the partners. On the contrary, the Commissioner made clear in his brief in the Tax Court (at 101) that these positions were inconsistent and that respondents could file a refund claim for the later years in the event that the Commissioner prevailed in the Tax Court with respect to the loss deductions.

In *National Carbide*, this Court had rejected a taxpayer's claim that certain subsidiary corporations created for a limited business purpose should be treated as nontaxable "agents" of their common shareholder-parent. The Court held instead that the corporate subsidiaries had to be recognized as separate taxable entities with respect to the income and expenses that they generated. The Court explained that "a corporation formed or operated for business purposes must share the tax burden despite substantial identity, in practical operation, with its owner" (336 U.S. at 429). Thus, the Court reaffirmed the holding of *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436 (1943), "that the tax laws require taxation of the corporate entity if it engages in 'business activity'" (336 U.S. at 426). The *National Carbide* Court went on to state in dictum, however, that its holding did not "foreclose a true corporate agent or trustee from handling the property and income of its owner-principal without being taxable therefor" (336 U.S. at 437).[3]

[3] The Court in *National Carbide* described the attributes of a "true corporate agent" as follows, and its description is often broken down (*e.g.*, Pet. App. 29a-32a) into six factors (336 U.S. at 437 (footnotes omitted)):

> [1] Whether the corporation operates in the name and for the account of the principal, [2] binds the principal

The Tax Court held that Creekside and Cloisters, the two corporations involved here, were "true corporate agent[s]" as hypothesized by this Court in *National Carbide*. Those corporations, the Tax Court observed (Pet. App. 29a-31a), did many things that agents normally do, such as "operat[ing] in the name * * * of the principal" and "transmit[ting] money received to the principal" (*National Carbide*, 336 U.S. at 437). This Court in *National Carbide* had also stated that, "[i]f the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case" (*ibid.*). The Tax Court concluded that this latter requirement was met as to five of the partnerships here, even though they had paid no compensation to Creekside for its services, since "in [those] five developments the partners did not own the stock of the corporation in the same percentage as their partnership interest" (Pet. App. 31a-32a). As to the sixth partnership and the two sole proprietorships, where the ownership percentages were identical, the Tax Court seemed to recognize that "the corporate-agent's relationship with the partnership [or proprietorship] *was* dependent on the fact of common ownership and control" (*id.* at 32a (emphasis added)). But the court nevertheless held

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by its actions, [3] transmits money received to the principal, and [4] whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists. [5] If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case. [6] Its business purpose must be the carrying on of the normal duties of an agent.

that Creekside and Cloisters could be regarded as "true agents" in those cases as well, since they "carried on only negligible activities" and assertedly "acted no differently than independent agents" (*ibid.*).

Finally, the Tax Court concluded (Pet. App. 32a-33a) that Creekside and Cloisters passed muster under *National Carbide*'s requirement that the "business purpose [of the supposed corporate agent] must be the carrying on of the normal duties of an agent" (336 U.S. at 437). The court noted that the corporations were "merely holding legal title to the property in order to satisfy the lenders' financing requirements," and that holding nominal title is a duty that agents often perform (Pet. App. 33a). And although Kentucky law required the corporations to be the borrowers on the mortgage notes, the Tax Court stated that "[t]he corporations did not act in any manner which could be interpreted as an assertion of principalship" (*ibid.*).

3. The Sixth Circuit affirmed (Pet. App. 1a-11a). It expressly "decline[d] to follow the Fourth Circuit's view, as expressed in *Ourisman*" (*id.* at 11a), which requires the demonstration of an arm's-length agency arrangement in order for a corporation-shareholder relationship to be recognized as a "true corporate agen[cy]" under *National Carbide*. The Sixth Circuit recognized that a truly independent agent would not normally agree to "perform all the work and then turn over the profits to its principal, in exchange for only nominal compensation" (*id.* at 7a). But although the corporations here received no compensation at all, the court concluded that they had "acted like agents," since their services consisted merely of borrowing money and holding nominal title to property, "the kind of task customarily undertaken by independent agents" (*id.* at 8a, 11a).

The court of appeals acknowledged the general rule that a corporation used for legitimate business purposes is a discrete entity that is taxed separately from its shareholders (*id.* at 6a). But the court stated that Bollinger and his partners "did not attempt to avail themselves of the normal benefits of doing business in the corporate form," even though Kentucky law would have prevented them from borrowing the necessary funds in any other way. Since the corporations here were used for the sole purpose of complying with state usury law, the court concluded, "[t]his is not * * * a situation where a taxpayer has embraced the advantages of doing business as a corporation and so, in fairness, must be held to the burdens as well as the benefits of the corporate form." *Id.* at 8a.

INTRODUCTION AND SUMMARY OF ARGUMENT

1. To put the question presented in context, it is useful to begin by summarizing a few basic principles of corporate taxation. The Internal Revenue Code generally requires that corporations be taxed separately from their shareholders. See *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436 (1943); *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422, 426 (1949). Thus, if a corporation has net income for a particular year, it is taxed on that income at its usual tax rate. No tax normally is paid by the shareholders unless and until the corporation distributes its earnings to them, either as dividends or as liquidating distributions. Use of the corporate form thus enables shareholders to defer payment of personal income taxes so long as the corporation's earnings remain undistributed. Once those earnings are distributed, however, the shareholders must pay

a separate tax, at their respective tax rates, on the dividends received or on the capital gain realized upon surrendering their shares in liquidation. See generally I.R.C. §§ 11, 301, 331.

Similar principles apply when a corporation has a net operating loss for a particular year. That loss is deductible by the corporation, and it may not be claimed by the shareholders on their personal tax returns. Instead, the corporation is permitted to carry the loss forward or back to other tax years, where it may be used to offset corporate income for those periods. See I.R.C. § 172. If the corporation has no income for those other tax years, the corporation's losses still may not be deducted immediately by the shareholders. Rather, the shareholders must wait until they sell their stock or until the corporation is liquidated, at which time the shareholders may realize a capital loss upon the disposition of their shares. See I.R.C. §§ 331, 1211.

Treatment of the corporation as a separate taxable entity is obviously the linchpin of this two-tiered tax structure. That treatment is essential in determining who is to report income and losses, as well as the proper timing of such reporting. If the corporation's separate existence were ignored, shareholders would be able not only to avoid the two-level tax on corporate earnings, but also to deduct corporate losses long before the corporation was dissolved.

Because use of the corporate form generally bars shareholders from taking immediate deductions for corporate losses, real estate "tax shelters" are typically organized either as sole proprietorships or as partnerships. Partnerships are "flow-through" entities for federal tax purposes, with items of income and expense being passed on to the partners, generally pro-rata, for inclusion on their personal tax

returns. It is presumably for this reason that respondents initially organized their eight real estate ventures either as partnerships or as sole proprietorships. But while this mode of organization was advantageous from a federal tax perspective, it proved disadvantageous from a business perspective, since Kentucky usury law prohibited noncorporate borrowers from receiving credit at prevailing market rates. Because that circumstance would have prevented respondents from borrowing at all, they organized a pair of corporations, Creekside and Cloisters, to borrow the funds for development and to hold the real estate as security for the loans.

The general tax principles just discussed would require that Creekside and Cloisters be treated as taxable entities distinct from their shareholders. Thus, the interest paid on the mortgage notes would normally be deductible by the corporation that borrowed the money, and the other expenses relating to the realty would normally be deductible by the corporation that held the land. To the extent that Bollinger and his partners personally disbursed funds to discharge these corporate expenses, those disbursements would be deemed contributions to the corporation's capital, serving to establish or increase those individuals' equity investments in the corporations. See *Commissioner* v. *Fink*, No. 86-511 (June 22, 1987), slip op. 5; *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590 (1943).

In seeking to avoid this result, respondents desire the best of both worlds. For state law purposes, they wish to have the corporations treated as the true borrowers and owners of the mortgaged realty, thus exploiting the corporate form to secure funds otherwise unavailable under Kentucky's usury statute.

For federal tax purposes, on the other hand, respondents seek to have the partnerships treated as the true borrowers and owners of the mortgaged realty, thus exploiting the noncorporate form to secure immediate loss deductions otherwise unavailable under the Internal Revenue Code. Respondents in our view simply cannot have it both ways. Having opted to establish corporations for a legitimate business purpose, respondents "must accept the tax consequences of [their] choice". *Commissioner* v. *National Alfalfa Deydrating & Milling Co.*, 417 U.S. 134, 149 (1974).

2. The theory that respondents advance in an effort to escape the tax consequences of their choice is that Creekside and Cloisters were acting merely as "agents" of their shareholders. From that premise, respondents argue that the interest deductions and other tax attributes that flow from borrowing the money and owning the realty do not belong to the corporations, but rather should be attributed to Bollinger and his partners as the corporations' "principals." See Br. in Opp. 2.[4] This argument, which

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[4] Respondents note in their brief in opposition (at 2) that they have never argued that the corporations "should be disregarded for federal income tax purposes," but have only contended that "the tax attributes arising from the ownership, construction and operation of the apartment complexes accrue to" respondents, not the corporations. There is no dispute between the parties on this point. Both parties agree that the corporations theoretically would be taxed as separate entities with respect to any income or expenses arising from other sources. Here, because Creekside and Cloisters evidently had no other business activity that could give rise to tax consequences, the "agency" treatment sought by respondents has the same effect as disregarding the corporation for tax purposes.

is based on an erroneous interpretation of this Court's decision in *National Carbide*, is altogether without merit.

The *National Carbide* decision, while rejecting an "agency" argument similar to that advanced by respondents here, did hypothesize that a situation might exist in which a corporation could function as the "true agent" of its shareholders. But the Court made clear that any such "true agent" would have to satisfy at least the following two conditions. First, the corporation's "business purpose must be the carrying on of the normal duties of an agent" (336 U.S. at 437). Second, "[i]f the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case" (*ibid.*).

Neither of these conditions is met here. First, the business purpose of Creekside and Cloisters was not "the carrying on of the normal duties of an agent." Those corporations' business purpose was to borrow money on terms unavailable to noncorporate borrowers. In order to achieve that purpose, the corporations could not have "acted like agents" (Pet. App. 11a), but rather must have acted like principals. If they had acted like agents, their actions, under hornbook agency law, would have been attributed to their shareholders as principals, and the loans in that event would have violated Kentucky's usury statute.

Second, the relations between the corporations (the supposed agents) and their shareholders (the supposed principals) were clearly dependent on the fact that the former were owned, in whole or substantial part, by the latter. In order to show the absence of such dependence, respondents would have had to demonstrate that the relationship conformed to the pattern of unrelated parties dealing with each other

at arm's length. Respondents plainly failed to prove such an arm's-length relationship, most obviously because neither corporation received any compensation whatsoever for performing very valuable, indeed essential, services for the eight real estate ventures over a period of several years.

ARGUMENT

RESPONDENTS' CORPORATIONS MAY NOT BE TREATED AS NONTAXABLE "AGENTS" OF THE PARTNERSHIPS AND PROPRIETORSHIPS, AND HENCE THE INCOME AND DEDUCTIONS ARISING FROM THE CONSTRUCTION AND OPERATION OF THE APARTMENT COMPLEXES MUST BE REPORTED FOR TAX PURPOSES BY THE CORPORATIONS

A. A Corporation Organized For A Business Purpose Or Engaged In Business Activity Must Be Recognized As A Taxable Entity Separate And Distinct From Its Shareholders

1. It is well settled that a corporation engaged in business activity is to be treated as a distinct taxable entity. This principle was firmly established by this Court's decision in *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436 (1943). The Court there rejected a taxpayer's claim that a corporation could be disregarded for tax purposes because of its identity of interest with its controlling shareholder.

In *Moline Properties*, an individual organized a corporation as a device to facilitate the taking out of a loan. In exchange for the corporation's stock, he transferred to it title to certain real property subject to a mortgage held by a third party. 319 U.S. at 437. Subsequently, the corporation sold part of the property at a profit, and the shareholder contended that no corporate tax was due on the gain. Rather,

because there was an identity of financial interest between himself and the corporation, he argued that the corporation could be disregarded for tax purposes and the gain from the sale be attributed directly to him. The Board of Tax Appeals accepted this contention, holding that, because of its "very limited purposes," the corporation "was a mere figmentary agent which should be disregarded in the assessment of taxes" (45 B.T.A. 647, 650 (1941)). The court of appeals reversed, holding that the corporate form, having been chosen by the shareholder for reasons sufficient to him, must be recognized in the taxation of the corporation's income (131 F.2d 388 (5th Cir. 1942)).

This Court affirmed the court of appeals, ruling that the corporation was a distinct taxable entity and that it was required to pay tax on the gain from the real estate transaction. The Court explained that "[t]he doctrine of corporate entity fills a useful purpose in business life" (319 U.S. at 438), one that is given effect in the tax laws. "Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity" (*id.* at 438-439) (footnotes omitted)). The fact that the corporation in *Moline Properties* was wholly owned by a single shareholder, and that it "kept no books and maintained no bank account during its existence" (*id.* at 438), did not in the Court's view call for a different result. "[T]he taxpayer had adopted the corporate form for purposes of

his own," the Court stated, and "[t]he choice of the advantages of incorporation to do business * * * required the acceptance of the tax disadvantages" (*id.* at 439).

The Court in *Moline Properties* also rejected the taxpayer's argument that the corporation was "a mere agent for its sole stockholder" and hence that "'the same tax consequences [should] follow as in the case of any corporate agent or fiduciary'" (319 U.S. at 440). Characterizing this argument as "basically the same argument of identity in a different form," the Court stated that the usual incidents of an agency relationship were not present (*ibid.*). As subsequently described by the Court, *Moline Properties* thus established the general rule that "the tax laws require taxation of the corporate entity if it engages in 'business activity'" (*National Carbide Corp.* v. *Commissioner*, 336 U.S. at 426).

The "separate entity" doctrine established in *Moline Properties* is a logical outgrowth of this Court's oft-repeated observation that a taxpayer has the choice in the first instance whether or not to do business in corporate form. "[W]hile a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not." *Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974); see also *Higgins* v. *Smith*, 308 U.S. 473, 477 (1940); *Old Mission Portland Cement Co.* v. *Helvering*, 293 U.S. 289, 293 (1934). In order to protect the fisc, of course, the courts have recognized that the Commissioner has the power, in appropriate circumstances, to disregard the transactional form used by the taxpayer—*e.g.*, where "the corporate form * * * is a sham or unreal" (*Moline Properties*, 319 U.S. at

439), or where the transaction serves no purpose other than to avoid taxation. See, *e.g.*, *Gregory* v. *Helvering*, 293 U.S. 465 (1935); *Shaw Construction Co.* v. *Commissioner*, 323 F.2d 316 (9th Cir. 1963); B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶¶ 1.05, 15.07, at 1-14 to 1-20, 15-35 to 15-36 (4th ed. 1979). As a general rule, however, corporate entities "will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages and where no violence to the legislative purpose is done by treating the corporate entity as a separate legal person." *Schenley Distillers Corp.* v. *United States*, 326 U.S. 432, 437 (1946).

2. There can be little doubt that the level of business activity engaged in by Creekside and Cloisters here was more than sufficient to require that those corporations be treated as "separate entities" under *Moline Properties*. The lower courts have stated that the degree of corporate activity needed to treat a corporation as a separate taxable entity is "minimal." *Britt* v. *United States*, 431 F.2d 227, 237 (5th Cir. 1970); see also *Ogiony* v. *Commissioner*, 617 F.2d 14, 16 (2d Cir.), cert. denied, 449 U.S. 900 (1980).[5]

[5] The courts have uniformly required that corporations be recognized as separate taxable entities in a variety of contexts where the corporations were employed for extremely limited purposes. See, *e.g.*, *Elot H. Raffety Farms, Inc.* v. *United States*, 511 F.2d 1234, 1239 (8th Cir.), cert. denied, 423 U.S. 834 (1975) (to obtain licenses to conduct business in foreign countries); *Britt* v. *United States*, *supra* (to facilitate transfer of partnership interests to children); *Tomlinson* v. *Miles*, 316 F.2d 710, 711 (5th Cir.), cert. denied, 375 U.S. 828 (1963) (to facilitate the management or conveyance of property owned by a group of investors); *Commissioner* v. *State-Adams Corp.*, 283 F.2d 395 (2d Cir. 1960) (to avoid difficulties in administration of property that might arise upon the death of the beneficial owners); *Paymer* v. *Commissioner*, 150 F.2d 334, 336-337 (2d Cir. 1945) (to protect property from creditors of the beneficial owners); *Vaughn* v. *United States*, 3 Cl. Ct. 316, 317 (1983), aff'd, 740 F.2d 941 (Fed. Cir. 1984) (to avoid personal liability with respect to loans incurred to acquire or improve property).

In particular, the courts have repeatedly held that a corporation used for the sole purpose of holding title and obtaining financing, in order to avoid state usury restrictions on loans to noncorporate borrowers, engages in sufficient business activity to require its recognition as a separate taxable entity. See, *e.g.*, *Ogiony* v. *Commissioner*, *supra*; *Evans* v. *Commissioner*, 557 F.2d 1095, 1099 (5th Cir. 1977); *Strong* v. *Commissioner*, 66 T.C. 12 (1976), aff'd, 553 F.2d 94 (2d Cir. 1977).

Thus, the Sixth Circuit below plainly erred in suggesting that the business activity of the corporations involved here was insufficient to invoke the "separate entity" doctrine, on the theory that respondents did not "embrace[] the advantages of doing business as a corporation and, so, in fairness, [should not] be held to the burdens as well as the benefits of the corporate form" (Pet. App. 8a). On the contrary, respondents, in establishing Creekside and Cloisters to hold title and to obtain loans that would not have been available to a noncorporate borrower because of Kentucky usury law, embraced one of the advantages of the corporate form that was specifically noted by this Court in *Moline Properties*—namely, "to gain an advantage under the law of the state of incorporation" (319 U.S. at 438). Respondents themselves concede (Br. in Opp. 2) that Creekside and Cloisters

were both "separate entities" and "viable entities." Under the fundamental principle laid down in *Moline Properties*, therefore, the net losses stemming from the apartment complexes involved here were attributable, not to respondents, but to the corporations that incurred the interest expenses and owned the secured property.

B. Attribution To Respondents Of The Corporations' Tax Attributes Cannot Be Justified On The Theory That The Corporations Acted Merely As The "Agents" Of Their Shareholders

The court of appeals rested its decision on the assertion that Creekside and Cloisters "acted like agents" of Bollinger and the partnerships in obtaining the mortgage loans (Pet. App. 11a). Relying on *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422 (1949), the court of appeals stated that this supposed principal-agent relationship superseded the *Moline Properties* "separate entity" rule. Even if the two corporations were viable separate entities, the court concluded, their income and expenses could thus be attributed directly to Bollinger and his partners under an agency theory.

The court of appeals' holding was error. This Court's decision in *National Carbide* did not undermine, but rather reaffirmed, the "separate entity" doctrine that the Court laid down several years earlier in *Moline Properties*. The latter decision, therefore, does not permit a corporation to escape taxation simply by characterizing the power exercised over it by its shareholders as the authority exercised over an agent by its principals. And although this Court in *National Carbide* did hypothesize the existence of a situation in which a corporation could function as a "true agent" of its shareholders, the situation involved here does not conform to the terms of the Court's hypothesis.

1. *The holding of* National Carbide *reaffirms that a controlled corporation must be treated as a separate taxable entity even if it can be characterized as an "agent" of its shareholders*

In *National Carbide*, the taxpayers made the same basic contention as respondents here—namely, that even though certain corporations were viable separate entities, the tax consequences of their operations were not attributable to them because they acted merely as "agents" of their common parent corporation. The Court in *Moline Properties* had briefly considered and rejected that contention. Noting that "the usual incidents of an agency relationship" were not present in that case, the Court stated that the taxpayer's argument was "basically the same argument of identity [between shareholder and corporation] in a different form," and that "the question of agency or not depends upon the same legal issues as does the question of identity previously discussed" (319 U.S. at 440-441). The Court in *National Carbide* reaffirmed and expanded upon this latter point (see 336 U.S. at 430), thereby firmly establishing the proposition that the "separate entity" doctrine cannot be avoided by the expedient of characterizing the controlled corporation's role as that of an "agent."

The taxpayers in *National Carbide* were three wholly-owned subsidiaries of Airco, which furnished the subsidiaries with their assets and directed their activities. Contracts between Airco and the subsidiaries provided that "the latter were employed as *agents* to manage and operate [production] plants • • • and as *agents* to sell the output of the plants"

(336 U.S. at 425; see *id.* at 424 n.1 (emphasis added)). The contracts further provided that the subsidiaries would turn over the bulk of their profits to Airco, except for a nominal sum that the subsidiaries would retain as " 'full compensation for [their] services" (*id.* at 425 n.1 (citation omitted)).[6] On the basis of these agreements, the taxpayers reported as income only the nominal sums that they had retained as a fee, and Airco reported the profits from the subsidiaries' operations as if they had been earned by Airco directly (*id.* at 424-426).

In rejecting the taxpayers' position, this Court explained that the complete control exercised by Airco, the sole shareholder, over its subsidiaries' operations furnished no basis for departing from the "separate entity" doctrine. "[W]e have held," the Court stated, "that a corporation formed or operated for business purposes must share the tax burden despite substantial identity, in practical operation, with its owner. Complete ownership of the corporation, and the control primarily dependent upon such ownership * * *[,] are no longer of significance in determining taxability" (336 U.S. at 429).

The Court specifically stated in this connection that it found "no significance" in the fact that the subsidiaries were "dummies" over which the Airco

[6] The agreements provided that the amount of this fee would be 6% of the outstanding capital stock of the subsidiary, which in each case was nominal in amount (336 U.S. at 425 & n.3). The figures for the three subsidiaries are set forth in the Tax Court's opinion as follows (8 T.C. 594, 597-598 (1947)): National Carbide transferred to Airco $713,788 in net profits and retained $300 as its fee; Air Reduction Sales Co. transferred to Airco $2,701,336 in net profits and retained $750 as its fee; and Pure Carbonic, Inc. transferred to Airco $218,687 in net profits and retained $300 as its fee.

board of directors exercised complete dominion (336 U.S. at 433). "Undoubtedly the great majority of corporations owned by sole stockholders," the Court stated, "are 'dummies' in the sense that their policies and day-to-day activities are determined not as decisions of the corporation but by their owners acting individually" (*ibid.*). The Court pointed out (*id.* at 433-434) that these facts were analogous to the factual finding in *Moline Properties* that the sole shareholder had "[f]ull beneficial ownership" (45 B.T.A. at 650) of the corporate real estate involved there, a circumstance that the Court in *Moline Properties* had found to be irrelevant. And the fact that the so-called "agency" agreements required Airco's subsidiaries to turn over their profits to their parent did not show that they were "mere collection agents." "Such an agreement," the Court explained, "is entirely consistent with the corporation-sole stockholder relationship whether or not any agency exists, and with other relationships as well" (336 U.S. at 436 (footnote omitted)). This Court accordingly affirmed the Second Circuit's decision in *National Carbide* (167 F.2d 304 (1948)), explicitly approving Judge Learned Hand's reasoning that "when a corporation carries on business activity the fact that the owner retains direction of its affairs down to the minutest detail, provides all of its assets and takes all of its profits can make no difference tax-wise" (336 U.S. at 431-432).

This Court's holding in *National Carbide* was based on the recognition that the domination typically exercised by a sole shareholder over his corporation is similar in many respects to the control exercised by a principal over his agent. As a result, the fact of such domination, and the ancillary consequences that normally flow from it, cannot alone serve as a

basis for treating the corporation as the shareholder's nontaxable "agent." Specifically, the Court found that the factors advanced by the taxpayers in *National Carbide*—control by Airco of the subsidiaries' day-to-day activities (336 U.S. at 433), the subsidiaries' holding title to property supplied by Airco for no consideration (*id.* at 434-435), and the transfer of property from the subsidiaries to Airco for little consideration (*id.* at 436)—evidenced nothing more than the common features of a sole shareholder's relationship with its controlled corporations. The Court accordingly held that these factors, without more, could not be relied upon to demonstrate the existence of a true agency arrangement. "Ownership of a corporation and the control incident thereto," the Court stated (*id.* at 430), "can have no different tax consequences when clothed in the garb of agency than when worn as a removable corporate veil."

This Court's holding in *National Carbide* thus provides no support whatsoever for the decision of the court of appeals in this case. The Court in *National Carbide* unequivocally held that a corporation organized for a legitimate business purpose or engaged in business activity must be treated as a separate taxable entity. And that is so even if the corporation can reasonably be characterized as a "dummy" whose day-to-day activities are totally dominated by its shareholders.

2. *The "true corporate agency" hypothesized in dictum by the* National Carbide *court is an extremely narrow exception to the general rule*

a. This Court's opinion in *National Carbide* did not end with the holding discussed above. It went on to state in dictum that "[w]hat we have said does not foreclose a true corporate agent or trustee from

handling the property and income of its owner-principal without being taxable therefor" (336 U.S. at 437). The Court had earlier noted (*id.* at 426-427) that the general proposition reflected in this dictum was not disputed by the parties. It is this dictum upon which the court of appeals relied in upholding respondents' claim that Creekside and Cloisters, the closely-held corporations involved here, should not bear the tax consequences arising from the ownership, construction, and operation of the apartment complexes.

The opinion in *National Carbide* did not exhaustively analyze the circumstances under which a "true corporate agen[cy]" could be recognized. It did, however, list a few of the common general characteristics of an agency relationship as "some of the relevant considerations in determining whether a true agency exists"—namely, "[w]hether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal." 336 U.S. at 437 (footnote omitted). The Court then added (*ibid.*): "If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purpose must be the carrying on of the normal duties of an agent." These latter two factors, which are stated in mandatory terms and which we believe to be the crucial ones, are often referred to as the "fifth" and "sixth" *National Carbide* factors. See, *e.g.*, Pet. App. 31a-33a.

The Court in *National Carbide* had no difficulty in concluding that the relations between Airco and its

subsidiaries did not conform to the "true corporate agen[cy]" thus hypothesized. In particular, the Court emphasized "the essentiality of ownership of the corporation to the existence of any 'agency' relationship" (336 U.S. at 437-438), a feature that similarly had dictated rejection of the taxpayer's "agency" argument in *Moline Properties*. Each subsidiary's relationship with Airco plainly was "dependent upon the fact that it [was] owned by [Airco]" (*id.* at 437), since the relationship in no way conformed to the norm of uncontrolled parties dealing with each other at arm's length. No rational agent, the Court suggested, would turn over $4 million in net earnings to its principal in exchange for a measly fee of $1,350. See *id.* at 438. The "business purpose" of Airco's subsidiaries, moreover, was plainly not "the carrying on of the normal duties of an agent" (*id.* at 437), for those corporations were operating companies that were intended to function as principals, not as agents of Airco. Indeed, the Court found it "apparent that Airco was attempting to *avoid* the status of principal *vis-à-vis* its subsidaries," since "[a]s principal it would have been subject to service of process through its agents," while "as owner of the subsidiary it was not" (*id.* at 439 n.21 (emphasis added)).

b. Since *National Carbide* was decided, this Court has never had occasion to specify, in concrete terms, what sort of arrangement between a sole shareholder and a controlled corporation would qualify as a "true corporate agency." The Court's holdings in that case and in *Moline Properties*, however, plainly suggest that the exception is a narrow one. It may be useful to offer an example of an arrangement that, in our view, would qualify.

Suppose a real estate partnership that does business both as a broker (acting as an intermediary between buyers and sellers) and as a dealer (dealing in real estate for its own account). Suppose that this partnership organizes a wholly-owned corporation whose business consists of serving as escrow agent in real estate transactions. Suppose further that the corporation serves as escrow agent for three categories of customers: (1) the partnership itself, in real estate transactions entered into for its own account; (2) other buyers and sellers, in transactions in which the partnership serves as broker; and (3) unrelated buyers and sellers, in transactions in which the partnership is not involved at all. Finally, suppose that the corporation charges all of its customers the same fees for the same services, and that its relations with its sole shareholder in other respects conform to the norm of arm's-length behavior.

This arrangement, we submit, would qualify as a "true corporate agency" under *National Carbide* even where the partnership itself is the customer. The corporation would satisfy the usual "agency" criteria mentioned by the Court, such as "operat-[ing] in the name * * * of the principal" and "transmit[ting] money received to the principal" (336 U.S. at 437). The "business purpose" of the corporation—holding the income or property of others in escrow—would be "the carrying on of the normal duties of an agent" (*ibid.*). And the relationship of the corporation with the partnership would "not be dependent upon the fact that it [was] owned by the principal," since the relationship would conform in all respects to the norm of unrelated parties dealing with each other at arm's length. Thus, although the partnership exercised control over the escrow corporation by virtue of owning all its stock, the corpora-

tion could "handl[e] the property and income of its owner-principal without being taxable therefor" (*ibid.*).

This example illustrates the sort of narrow exception that we believe the *National Carbide* Court intended when it hypothesized the existence of a "true corporate agency." The courts below, however, have extended the narrow exception far beyond its intended confines by failing to adhere to the specific limitations articulated by this Court.

3. *The relationship between respondents' corporations and the partnerships does not qualify as a "true corporate agency"*

The courts below erred in holding that Creekside and Cloisters functioned as "true corporate agents" of Bollinger and his partners. First, the "business purpose" of those corporations was not "the carrying on of the normal duties of an agent" (*National Carbide*, 336 U.S. at 437), but rather was the carrying on of the normal duties of a principal. Second, Creekside and Cloisters were owned by Bollinger and his partners, and the corporations' relations with their so-called "principals" were obviously "dependent upon tha[t] fact" in that they did not conform to arm's-length standards (*ibid.*). In holding to the contrary, the courts below relied upon a miscellany of other factors, some of which were mentioned by the Court in *National Carbide*, such as the fact that Creekside and Cloisters operated in the name of the partnerships and transmitted money to them. This reliance was error, since these factors are characteristic *both* of a shareholder-corporation relationship *and* of a principal-agent relationship, and hence do not show that the former has been transmuted into the latter.

a. The so-called "sixth *National Carbide* factor" requires that the "business purpose" of a true corporate agent "must be the carrying on of the normal duties of an agent" (336 U.S. at 437 (footnote omitted)). This factor plainly was not met here. Although the court of appeals asserted that Creekside and Cloisters "acted like agents" (Pet. App. 11a), accomplishment of their business purpose in fact required that they act like principals. It is black-letter agency law that an act by an agent on behalf of its principal is deemed to be an act of the principal. Restatement (Second) of Agency § 1 (1958). See, *e.g.*, *Nelson* v. *Serwold*, 687 F.2d 278, 282 (9th Cir. 1982); *Lubbock Feed Lots, Inc.* v. *Iowa Beef Processors*, 630 F.2d 250, 272 (5th Cir. 1980). If the corporations were "true agents" of Bollinger and the partnerships, then the corporations' actions in obtaining the mortgage loans would have been deemed the actions of Bollinger and his partners. But that would have violated Kentucky usury law, which prohibited the extension of credit to noncorporate borrowers on the terms that Creekside and Cloisters received.

In short, the "business purpose" for which Creekside and Cloisters were created—to obtain financing for the apartment complexes in a manner consistent with Kentucky's usury law—could be accomplished only if the corporations borrowed the money as principals. In the words of the Fourth Circuit, describing the same arrangement that is involved here, each corporation's "ability to borrow money was premised on its status as a principal rather than as the agent of a noncorporate borrower" (*Frink* v. *Commissioner*, 798 F.2d 106, 110 (1986), petition for cert. pending, No. 86-1151). Just as Airco, the putative "principal" in *National Carbide*, in reality "wished to

avoid the burdens of principalship" (336 U.S. at 438), so Bollinger and his partners, the putative "principals" here, wished to avoid a fatal "burden[] of principalship" under Kentucky law—the inability of noncorporate borrowers to borrow construction funds at prevailing market rates.[7]

b. The so-called "fifth *National Carbide* factor" requires that, "[i]f the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case" (336 U.S. at 437). Creekside and Cloisters, the so-called "agents" here, were owned, in whole or substantial part, by their so-called "principals." In the case of Bollinger's two sole proprietorships and the Cloisters partnership, the ownership interests in the respective entities were identical. For that reason, the Tax Court conceded that "the corporate-agent's relationship with the [Cloisters] partnership *was* dependent on the fact of common ownership and control" (Pet. App. 32a (emphasis added)). The same conclusion necessarily follows in the case

[7] Significantly, none of the loan documents (such as the notes and mortgages) pertaining to the various real estate projects indicated that Creekside and Cloisters were engaging in the transactions as agents for anyone. It is no doubt true that the lenders knew that the corporations acted as the borrowers in order to satisfy Kentucky's usury law, and that the lenders knew the borrowed funds would be used for the benefit of Bollinger and the partnerships (see Br. in Opp. 2-3). But those facts provide no reason for federal tax authorities to ignore the existence of a corporation recognized for purposes of state law. As Justice Holmes noted, writing for the Court in another context (*Klein* v. *Board of Tax Supervisors*, 282 U.S. 19, 24 (1930)): "[I]t leads nowhere to call a corporation a fiction. If it is a fiction it is a fiction created by law with intent that it should be acted on as if true."

of the relationship between Creekside and Bollinger's two proprietorships.

In the case of the other five partnerships, the apparent ownership interests in the respective entities were somewhat different, since Bollinger nominally owned 100% of Creekside's stock, yet held partnership interests ranging from 33⅓% to 66⅔%. See Pet. App. 18a. But the Tax Court erred in concluding that this disparity in nominal stockholdings conclusively demonstrated an absence of "common ownership" within the meaning of *National Carbide*. The relationship between a putative "agent" and a putative "principal" may well depend upon the fact of common *control* exercised by means of common ownership, even if the ownership is not in precisely the same proportion.[8] It is clear that Bollinger exercised such control by means of his overlapping ownership interests here.[9] In short, the disparity in

[8] In any event, even though Bollinger *nominally* owned 100% of Creekside's shares, his partners would be regarded, for federal tax purposes and presumably for state-law purposes, as *constructively* owning ratable portions of its stock. That is because expenditures made by the partners to discharge Creekside's interest expenses and other liabilities would be deemed contributions to Creekside's capital, and hence would serve to establish or increase those individuals' equity stake in the corporation. See *Commissioner* v. *Fink*, No. 86-511 (June 22, 1987), slip op. 5; *Deputy* v. *du Pont*, 308 U.S. 488 (1940).

[9] The record indicates that Bollinger, the sole owner of Creekside, was the dominant voice in all the partnerships. He served as the general contractor for the projects and arranged the necessary financing. See Pet. App. 3a-4a. In fact, "in all loan commitment letters, except the one for Cloister Apartments, the financial institution required that the loan be made to the corporate nominee of Jesse C. Bollinger" (*id.* at 24a). Thus, it is apparent that the partnerships and Creekside were both controlled by Bollinger, and it cannot seriously

nominal stockholdings was largely illusory in this case, and Creekside should therefore be regarded as "owned by" its supposed principals (336 U.S. at 437) for purposes of the *National Carbide* "agency" analysis.

The record plainly demonstrates that the relations tween Creekside and the partnerships were "dependent upon" this fact of common ownership and control (*National Carbide*, 336 U.S. at 437). This is conclusively established, without more, by the fact that Bollinger and the partnerships paid no fee to their putative corporate agents for the services being rendered to them, even though those services, rendered over a period of several years, were extremely valuable. Indeed, those services were *essentiai* to the very existence of the real estate projects, since the necessary financing could not have been obtained but for the corporations' intervention. The arrangement between the corporations and their owners was thus inconsistent with an arm's-length arrangement between an unrelated principal and agent, and hence it did not amount to a "true corporate agency" as hypothesized by this Court in *National Carbide*.

c. In holding that Creekside and Cloisters were "true corporate agents," the Tax Court and the court of appeals paid little more than lip service to the two critical factors that we have just discussed. Instead, the courts below relied upon a miscellany of other considerations listed by the *National Carbide* Court as "some of the relevant considerations in determining whether a true agency exists" (336 U.S. at 437). But these considerations cannot have been intended as anything more than a bare threshold for

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be disputed that the relationship between them was dependent upon the fact of this common control.

analyzing an "agency" claim. The fact that a corporation "operates * * * for the account of" its shareholders or "transmits money" to them (*ibid.*) cannot alone justify a finding of "true corporate agency," since those characteristics are typically found in the often-informal relationship that exists between shareholders and their closely-held corporations. As the Court stated in *Moline Properties*, these basic agency characteristics merely reflect "identity [between the shareholder and the corporation] in another form" (319 U.S. at 440). If the presence of these characteristics were enough to avoid the "separate entity" doctrine, almost any shareholder that controlled a closely-held corporation could structure its affairs so as to avoid corporate taxation when it suited its purposes, even when the corporation was necessary to serve important business ends. This Court's holdings in *Moline Properties* and *National Carbide* plainly do not countenance that result.

The considerations cited by the Tax Court in this case show that it erroneously predicated a finding of "true corporate agency" on attributes that simply reflect the identity of interest between a closely-held corporation and its shareholders. For example, the Tax Court emphasized that Creekside and Cloisters "carried on only negligible activities" and that Bollinger and his partners personally guaranteed payment of the corporations' loans and personally operated and maintained the apartment complexes (see Pet. App. 28a, 31a-32a). But *National Carbide* clearly establishes that "dummy" corporations cannot be ignored for tax purposes simply because their owners guarantee their financial obligations and control their

day-to-day operations (336 U.S. at 433-434).[10] Similarly, the fact that Creekside and Cloisters were used to hold title to the mortgaged realty at the lenders' insistence (see Pet. App. 29a) merely underscores that the corporations served a valid business purpose under Kentucky law, thereby making them separate taxable entities under *Moline Properties*; it does not suggest that the corporations acted as agents. And the fact that Bollinger and the partnerships were the "true economic owners" (Pet. App. 34a) of the apartment complexes is immaterial. Such identity of economic interest was recognized by this Court in both *National Carbide* (336 U.S. at 433-434) and *Moline Properties* (319 U.S. at 440-441) as a natural consequence of a shareholder's control of his closely-held corporation, a consequence that provides no basis for disregarding the corporation on an "agency" theory.

The court of appeals' opinion, while somewhat cryptic, also misses the mark. It recited some of the facts indicating that Creekside and Cloisters were dummies subject to the partners' control, placing particular emphasis on the fact that beneficial ownership of the real estate rested with the latter (see Pet. App. 5a-6a). But these facts, as we have just explained, do not suffice to prove a "true corporate agency." The court of appeals stated that "holding

[10] It is common for creditors of closely-held corporations to look to the shareholders for repayment of loans and therefore to require personal guarantees. See, *e.g.*, *Golder* v. *Commissioner*, 604 F.2d 34 (9th Cir. 1979); *Martens* v. *Barrett*, 245 F.2d 844, 848 (5th Cir. 1957). The loan guarantee thus simply reflects the shareholder-corporation relationship, not any special agency relationship. Indeed, if the corporations here were true agents, the loans would not have been "guaranteed" by the partnerships, since they would have been the direct obligation of the partnerships.

nominal title is the kind of task customarily undertaken by independent agents" (*id.* at 8a), but it ignored the fact that borrowing construction funds at market interest rates, under Kentucky usury law, was not a task that could be undertaken by the agent of a non-corporate borrower. The court of appeals asserted that each corporation "conduct[ed] itself no differently than would an independent agent which had bargained with its principal for its services at arm's length" (*id.* at 10a), but the court ignored the fact that neither corporation bargained for any compensation in exchange for its services. And while the court of appeals surmised that "[a] corporation unrelated to [Bollinger and his partners] could just as well have been entrusted to hold nominal title to avoid usury problems" (*id.* at 8a), this was not in fact what Bollinger and his partners actually chose to do.[11]

[11] There may be legitimate business reasons why a taxpayer would not want to use an unrelated corporation to serve as an "agent" or "dummy" corporation. In the *Frink* case, the court of appeals noted that the partners had considered and rejected the idea of using an unrelated corporation to hold title to property and obtain a loan to develop it. See *Frink* v. *Commissioner*, 798 F.2d at 108; see also *Harrison Property Management Co.* v. *United States*, 475 F.2d 623, 628 (Ct. Cl. 1973), cert. denied, 414 U.S. 1130 (1974) (discussing business reasons for using related corporation). The reasons for desiring to use a related corporation are quite apparent in the context involved here; the beneficial owners of valuable property justifiably may be reluctant to confer title to that property upon an unrelated party. For example, the surrender of title to an unrelated party, even when accomplished by means of agreements that safeguard the owners' interest, renders the property vulnerable to the claims of the unrelated party's creditors. Of course, the fact that taxpayers like respondents have sound business reasons for using controlled corporations to hold title and obtain loans in order to comply with state

d. The inadequacy of the court of appeals' analysis is demonstrated by the decisions of the other courts of appeals that have considered the question presented here. These other courts of appeals have correctly held that any finding of "true corporate agency" in the context of a controlled corporation must rest, at a minimum, upon a finding that the corporation-shareholder relationship is indistinguishable from an arm's-length relationship between an agent and an unrelated principal. And these courts have uniformly held that a corporation established for the sole purpose of holding title and obtaining a loan to satisfy state usury laws is not a "true agent" of its shareholders within the meaning of *National Carbide*. See *George* v. *Commissioner*, 803 F.2d 144 (5th Cir. 1986), petition for cert. pending, No. 86-1152; *Frink* v. *Commissioner*, *supra*; *Ourisman* v. *Commissioner*, 760 F.2d 541 (4th Cir. 1985); *Roccaforte* v. *Commissioner*, 708 F.2d 986 (5th Cir. 1983); see also *Harrison Property Management Co.* v. *United States*, 475 F.2d 623 (Ct. Cl. 1973), cert. denied, 414 U.S. 1130 (1974) (corporation established for limited purpose of providing more efficient management in the event of the death of one of the partners).

The Fourth Circuit in *Ourisman* cogently explained why the *National Carbide* dictum must be held to require proof of an arm's-length arrangement. "[I]f the agency relationship could not exist but for the shareholders' ownership and control of the corporate

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usury laws merely underscores that the relationships between these taxpayers and their corporations are "dependent upon the fact that [the corporations are] owned by the principal" (*National Carbide*, 336 U.S. at 437), and therefore that the *National Carbide* dictum provides no basis for disregarding the corporations as separate taxable entities.

agent, the alleged agency relationship is nothing more than a manifestation of the underlying corporation-shareholder relationship and * * * the corporation therefore must be regarded as a separate taxpaying entity under our system of separate taxation of corporations" (760 F.2d at 549). If the rule were otherwise, the court continued, "shareholders with impunity could take advantage of the system of separate taxation of corporations by treating their corporation as a separate taxable entity with respect to some transactions while treating the corporation as a nontaxable agent with respect to other transactions" (*ibid.*). Failure to apply this "arm's-length requirement" set forth in *National Carbide*—a requirement overlooked by the courts below—would yield a prescription for "abuse" under which "the separate entity regime would collapse" (*Roccaforte* v. *Commissioner*, 708 F.2d at 990; see also *Ourisman* v. *Commissioner*, 760 F.2d at 549).[12]

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[12] The other courts of appeals have also held that the determination whether the alleged principal-agent relationship is independent of the fact of ownership must be made on the basis of the *actual* relationship between the shareholders and the corporation, not on the basis of the hypothetical conclusion (invoked by the court below, Pet. App. 8a) that an unrelated agent *could* have been used. See *George* v. *Commissioner*, 803 F.2d at 149. In analyzing this question, the other courts of appeals have also agreed, contrary to the Tax Court's conclusion in this case, that a disparity in the percentage interests nominally held by the investors in the partnerships and the corporation, respectively, does not prove that the relationship between the two is independent of the fact of ownership. Rather, if the same parties control both entities, the *National Carbide* arm's-length requirement will not be met even if the precise ownership percentages are different. See *George* v. *Commissioner*, 803 F.2d at 148; *Frink* v. *Commissioner*, 798 F.2d at 109. Cf. *Raphan* v. *United States*,

Of particular relevance here, the other courts of appeals are agreed that an essential prerequisite to finding an arm's-length agency relationship is the payment of a reasonable fee to the supposed agent for its services. Because an unrelated agent could not be expected to provide services without compensation, the absence of such a fee arrangement conclusively shows that the putative agent's "relations with its principal [are] dependent upon the fact that it is owned by the principal" (*National Carbide*, 336 U.S. at 437), and hence that no "true agency" exists. See *George* v. *Commissioner*, 803 F.2d at 148-149; *Frink* v. *Commissioner*, 798 F.2d at 110; *Roccaforte* v. *Commissioner*, 708 F.2d at 990 n.4; see also *Jones* v. *Commissioner*, 640 F.2d 745, 754 (5th Cir.), cert. denied, 454 U.S. 965 (1981).

C. Treatment Of Respondents' Corporations As "True Corporate Agents" Cannot Be Justified By Reference To Considerations Of Fairness Or Of Tax Policy

1. Legislative developments since *National Carbide* was decided strongly suggest that recognition of an "agency exception" in the circumstances of this case would be inconsistent with federal tax policy. In 1954 Congress added Subchapter S to the Internal Revenue Code. See 26 U.S.C. 1361-1379. This sub-

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759 F.2d 879, 883 (Fed. Cir.), cert. denied, 474 U.S. 843 (1985) (affirming, as not clearly erroneous, the trial court's finding that a purported corporate agent and a partnership were not under common control where the owners of the corporation held a 50% interest in the partnership); *Moncrief* v. *United States*, 730 F.2d 276, 284-286 (5th Cir. 1984) (reinstating jury verdict that the purported corporate agent of a partnership was not subject to common control where the corporation was wholly owned by a partner holding a 25% interest in the partnership).

chapter establishes, in considerable detail, the circumstances under which certain "small business corporations" can be treated as flow-through entities for federal tax purposes. If the provisions of Subchapter S are satisfied, the corporation may elect to have its income and expenses treated as belonging to its shareholders, with the result that the corporation itself is not separately taxed. Corporations qualifying under Subchapter S thus receive the exact treatment that respondents seek here: they remain corporations for business purposes, yet they are taxed essentially as partnerships.

In Subchapter S of the Code, Congress has turned its specific attention to the question whether, and under what circumstances, taxpayers should be permitted to take advantage of the corporate form for business purposes, yet avoid perceived disadvantages of the corporate form for federal tax purposes. In enacting Subchapter S, Congress sought to ameliorate what it viewed as arguably harsh consequences of the unmodified application of the "separate entity" doctrine of *Moline Properties*. By the same token, Congress's decision not to tamper with that general rule in connection with corporations not covered by Subchapter S reflects the legislature's view that the application of the "separate entity" doctrine to such corporations is entirely appropriate.

Respondents in this case could not avail themselves of the benefits of Subchapter S in connection with the development of their apartment complexes. That is because Section 1362(d) of the Code provides that a Subchapter S corporation may derive no more than 25% of its income from passive sources, including rents. This restriction stems from a considered judgment by Congress. See S. Rep. 1622, 83d Cong., 2d Sess. 119 (1954). It would thwart this evident con-

gressional intent if, through the expedient of characterizing the corporations involved here as "agents," respondents could nonetheless obtain tax benefits indistinguishable from the "privilege" (*ibid.*) of Subchapter S treatment that is denied to them by Section 1362(d). See *Harrison Property Management Co.* v. *United States*, 475 F.2d at 629-630.

2. It may well be that, as a matter of economic reality, respondents were faced with a "Hobson's choice" in deciding whether to pursue their apartment projects. Unless they were willing to forgo the projects for lack of financing, they were forced to borrow money through a corporation, thereby entailing the tax disadvantage of a separate corporate-level tax. But there is nothing inherently unfair about this predicament. Indeed, the fact that respondents were forced to do their borrowing by way of a corporation "'merely serves to emphasize [the corporation's] separate existence'" (*Strong* v. *Commissioner*, 66 T.C. at 26 n.12 (quoting *Moline Properties*, 319 U.S. at 440)). And Congress has made the judgment in Section 1362(d) that a corporation organized for this kind of business purpose may not avail itself of the benefits accorded to qualifying "small business corporations" under Subchapter S of the Code.

During the years at issue here, Kentucky law prohibited lenders from extending credit to individuals or partnerships at the interest rate at which respondents found it necessary to borrow. Respondents were able to borrow consistently with Kentucky law only because they deliberately availed themselves of the corporate form in order to obtain the loans. It thus takes some degree of effrontery to argue that the federal tax authorities must disregard the very corporation whose separate existence was designed

by respondents to be brandished before state banking authorities. There is no reason why respondents should be allowed to enjoy whatever advantages attach under state law to borrowing through a corporation, only to repudiate the corporate form later with the idea of claiming the corporation's expenses as "tax shelter" losses on their personal income tax returns. Acceptance of that argument is surely not compelled by any abstract notions of fairness, and it might be viewed as assisting respondents and their lenders in evading a requirement of state law. Accordingly, there is no reason to depart here from the well-established principle that once "the taxpayer ha[s] adopted the corporate form for purposes of his own[,] [t]he choice of the advantages of incorporation to do business * * * require[s] the acceptance of the tax disadvantages" (*Moline Properties*, 319 U.S. at 439).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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RESPONDENT'S

BRIEF

No. 86-1672

In The
Supreme Court of the United States
October Term, 1987

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

JESSE C. BOLLINGER, JR., *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENTS

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QUESTION PRESENTED

Whether the income and losses generated by the construction and operation of various apartment complexes are attributable to the proprietorship or partnership which owned, constructed and operated the particular apartment complex or to the nominee corporation created to act as agent to hold record title to the property for the purpose of obtaining construction and permanent financing.

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BRIEF FOR THE RESPONDENTS

STATEMENT OF THE CASE

1. The respondent, Jesse C. Bollinger, Jr. ("Bollinger") was a real estate developer. Commencing in 1968, Bollinger participated in the development of eight apartment complexes in Lexington, Kentucky. Two of the apartment complexes (Creekside North Apartments and Ski Lodge Apartments) were developed by Bollinger as a sole

proprietor. The six remaining apartment complexes (Carriage Hill Apartments; Creekside South Apartments; Les Chateaux Apartments; Lamplighter Apartments; Two Lakes Apartments and Cloister Apartments) were developed by six partnerships in which Bollinger was a partner. The respondents Edward H. Peter, Jr. ("Peter") and Paul W. Hensley ("Hensley") were partners in some but not all of the partnerships. (2a, 17a-19a).

During the years in issue, Kentucky law provided, generally, that a loan made to a noncorporate borrower at a rate exceeding seven percent (7%) per annum was usurious. The prevailing local interest rate at that time for construction and permanent financing was in excess of seven percent (7%) per annum. For this reason, the financial institutions which provided construction and permanent financing for development of the apartment complexes required that the nominal debtor be a corporate nominee of the partnerships[1] and that record title to the property be held by the corporate nominee. Accordingly, record title to the various properties was held by a corporation as a device to comply with the Kentucky usury statutes. (Pet. App. 2a, 17a-19a). Creekside, Inc., a corporation wholly owned by Bollinger, held record title to seven of the apartment complexes. Cloisters, Inc., a corporation owned equally by Bollinger and Mr. George Martain ("Martin"), held record title to the Cloister Apartments.[2] (Pet. App. 2a-3a n.1 and 18a).

[1]For purposes of this brief, as did the Tax Court (Pet. App. 17a n.2), the respondents will refer to the sole proprietorships owned by Bollinger as partnerships.

Bollinger initiated plans sometime during 1968 to develop the Creekside North Apartments on a portion of land owned at the time by Beacon Hill, Inc.[3] In order to secure the construction loan and permanent financing for the proposed development, Bollinger consulted with Mr. Bryan Sumner ("Sumner"), a mortgage banker in Louisville, Kentucky. Bollinger was advised that financing could be obtained only through a "corporate nominee." (Pet. App. 3a, 19a).

On July 24, 1968, Sumner obtained a loan commitment for permanent financing from Massachusetts Mutual Life Insurance Company ("Massachusetts Mutual Life") in which Massachusetts Mutual Life agreed to loan $1,075,000.00 to "the corporate nominee of Jesse C. Bollinger, Jr." at an interest rate of eight percent (8%) per annum. The loan was to be secured by a mortgage on the Creekside North Apartments and by a personal guarantee of Bollinger. (Pet. App. 3a, 19a).

Bollinger desired to hold title to the Creekside North Apartments in his individual name. To achieve this purpose, he conferred with his accountant and his attorney, and they advised him that the use of corporate nominees in order to obtain construction financing was common

[2]A chart summarizing for each apartment complex, the partnership constructing the complex, the individual's interest in the partnership and the corporate nominee holding record title to the complex was included in the opinion of the Tax Court (Pet. App. 18a) and Court of Appeals (*id.* at 2a-3a n.1).

[3]Beacon Hill, Inc. was a corporation wholly owned by Bollinger and Peter. (Transcript ("Tr.") 135).

practice in the State of Kentucky. On October 14, 1968, Bollinger incorporated Creekside, Inc., under the laws of the State of Kentucky, for the sole purpose of having a nominee corporation to secure financing for the development of his apartment projects. At all relevant times Bollinger was the sole shareholder of Creekside, Inc. (Pet. App. 3a, 20a).

On October 15, 1968, Bollinger and Creekside, Inc., entered into an agreement which provided, generally, that (a) Creekside, Inc., would hold title to the Creekside North Apartment complex as Bollinger's agent only for the purpose of securing temporary and permanent financing of the project, (b) Creekside, Inc. would convey, assign or encumber the property and deliver the proceeds thereof only as directed by Bollinger, (c) Creekside, Inc. had no obligation to either care for or maintain the property or assume any liability for payment of money by execution of promissory notes or otherwise, and (d) Bollinger would indemnify and hold Creekside, Inc. harmless from and against any liability it may or might sustain by reason of acting as his agent or nominee.[4] (Pet. App. 3a-4a, 20a-21a n.4).

Bollinger, through Creekside, Inc., borrowed the construction funds for the Creekside North Apartments development from Citizens Fidelity Bank and Trust Company ("Citizens Fidelity"). Creekside, Inc., executed all necessary loan documents including the promissory note and mortgage. Upon receipt, Creekside, Inc. transferred

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[4]The relevant portions of the agreement are quoted in the Tax Court opinion. (Pet. App. 20a-21a n.4).

all loan proceeds to Bollinger's individual construction account. (Pet. App. 4a, 21a).

During construction of the Creekside North Apartments, Bollinger acted as general contractor and employed Hensley on a fixed fee basis as construction supervisor. Hensley supervised the construction, ordered materials, scheduled the work and received, reviewed, and approved all invoices. Hensley, after conferring with Bollinger, paid the construction costs from the construction account. On completion of the Creekside North Apartments, Bollinger, through Creekside, Inc., obtained permanent financing from Massachusetts Mutual Life in accordance with its commitment letter of July 24, 1968. This loan was secured by a mortgage upon Creekside North Apartments and by a partial personal guarantee executed by Bollinger. The loan proceeds received from Massachusetts Mutual Life were used to pay off the prior construction loan obtained from Citizens Fidelity. (Pet. App. 4a, 21a-22a).

After the Creekside North Apartments were completed, Bollinger employed a resident manager to rent the apartments, execute leases for apartment rental, collect and deposit the rent received, and maintain operating records. (Pet. App. 22a).

The income and losses generated by the Creekside North Apartments were reported by Bollinger on his individual income tax returns for the years in issue. (Pet. App. 4a, 23a).

Pursuant to a substantially identical pattern, the applicable respondents secured financing for construction of the other seven apartment complexes through the use of a corporate nominee. For each of the respective apartment

complexes (a) the financial institution required that the construction loans and permanent financing be made to a corporate nominee, with at least a partial personal guarantee by the partners; (b) the partnerships and the applicable corporation executed nominee or agency agreements, which were similar in all relevant respects to the agreement executed by Bollinger with respect to the Creekside North Apartments property; and (c) the corporation transferred the construction loan proceeds upon receipt to the partnership's construction account from which all invoices were paid by the construction supervisor hired by the partnership. (Pet. App. 3a, 4a, 23a).

Upon completion of each apartment complex, the corporate nominee secured permanent financing, which was used to pay off the construction loan. Each partnership actively managed its respective apartment complex. All rental receipts were deposited into and all expenses were paid from a separate partnership account. Income and losses generated by each of the apartment complexes, except Ski Lodge, were reported by the respective partnerships on U.S. Partnership returns filed for the years in issue. The respondents in turn reported their distributive share of the partnership income and losses on their individual income tax returns filed for the years in issue. Bollinger reported the income and losses generated by Ski Lodge Apartments, a sole proprietorship, on his individual income tax returns for the years in issue. (Pet. App. 4a-5a, 23a-24a).

At all relevant times, Bollinger, or the respective partnership, intended to retain all but record title to the apartment complexes. They always regarded themselves as the real owners of the property. It was only because the financial institutions would not provide a construction loan or permanent financing for the projects to either a partnership or an individual that record title to the various properties was held by a nominee corporation. (Pet. App. 5a, 24a).

During the years in issue, the corporations had no liabilities, assets, employees, or bank accounts; nor did they manage the apartment complexes once the buildings were placed into service. (Pet. App. 25a). At all relevant times, the lenders regarded Bollinger, or the respective partnership, as the owners of the apartment complexes. (Pet. App. 18a, 24a). The lenders were not only well aware that Creekside, Inc. and Cloisers, Inc. were merely corporate shells, but they were also aware that the corporations were acting as agents of the partnerships by merely holding legal title to the property in order to satisfy the lenders' financing requirements. (Pet. App. 29a, 33a). The lenders required partial personal guarantees from the partners and looked to them for repayment. (Pet. App. 18a, 24a).

Creditors of the various apartment projects, if they knew about the corporations, were all well aware that the corporations were merely acting for the partnerships. (Pet. App. 29a-30a).

The partnerships made all the principal and interest payments on the construction loans and permanent financing and paid all the other expenses associated with the apartment complexes. (Pet. App. 29a-30a). The respondents sought none of the traditional insulating benefits of a corporate shareholder, and there was no tax-avoidance scheme involved in the use of the corporations as agent. (Pet. App. 4a, 33a-34a).

In statutory notices of deficiency issued to the respondents, the Commissioner of Internal Revenue ("Commissioner") maintained inconsistent positions with respect to the partnerships. In the earlier years, he disallowed the income and losses claimed by the respondents for their respective shares of the partnership income and losses upon a determination that such income and losses were those of the corporation holding record title to the real estate. However, in the later years (1976 and 1977), when most of the partnerships generated income, the Commissioner attributed the income and losses to the partners. (Pet. App. 25a and n.5 at 25a).

2. The respondents sought redetermination of the proposed deficiencies by filing petitions with the United States Tax Court ("Tax Court"). In holding for the respondents, the Tax Court relied upon this Court's acknowledgment in *National Carbide Corp. v. Commissioner*, 336 U.S. 422 (1949), that even a controlled corporation can qualify as a true agent or trustee, and, as such, can handle the property and income of its owner-principal without being taxable therefor, and upon this Court's analysis of the characteristics of a true corporate agent. (*id.* at 437 and Pet. App. 27a-34a). The Tax Court found the facts of this case to establish that " . . . the partnerships, and not the corporations, were the owners of the apartment complexes for Federal income tax purposes." (Pet. App. 29a). The Tax Court held that the corporations were acting as agents for the applicable proprietorship or partnership and that the income and losses from the ownership, construction and operation of the apartment complexes were attributable to the applicable proprietorship or partnership. (Pet. App. 14a-34a).

3. The Commissioner filed a notice of appeal to the United States Court of Appeals for the Sixth Circuit ("Sixth Circuit"), which Court affirmed the decision of the Tax Court. (Pet. App. 1a-11a). In affirming, the Sixth Circuit was likewise guided by this Court's analysis in *National Carbide*, and interpreted *National Carbide* as requiring " . . . an inquiry into the actual substance of the relationship to determine if an agency existed in fact." (Pet. App. 10a-11a). The Sixth Circuit concluded that the *National Carbide* requirements are satisfied " . . . when the evidence establishes that the attributes of an agency are present, and the corporate nominee conducts itself no differently than would an independent agent which had bargained with its principal for its services at arm's length . . .". (Pet. App. 10a).

Relying primarily upon *Ourisman v. Commissioner*, 760 F.2d 541 (4th Cir. 1985), rev'g 82 T.C. 171 (1984), the Commissioner argued to the Sixth Circuit that *National Carbide* required the respondents' evidence to "establish that the agency relationship was, in fact, an arm's length arrangement." (Pet. App. 9a). The Sixth Circuit criticized the Fourth Circuit's approach in *Ourisman* as exalting form over substance (Pet. App. 10a) and stated that "[w]hen the Supreme Court, in *National Carbide*, said that, under certain circumstances, a true corporate agent is not foreclosed from handling the property and income of its owner-principal without being taxable, it could not have contemplated so strict a reading of circumstances that, as a practical matter, the existence of a true agency would be foreclosed." (Pet. App. 10a). The Sixth Circuit, therefore, declined " . . . to follow the Fourth Circuit's view, as expressed in *Ourisman*." (Pet. App. 11a).

4. The Commissioner's petition to this Court for writ of certiorari was granted on June 8, 1987. The Commissioner argued in his petition that the Sixth Circuit's opinion in this case conflicts with (a) the decisions of the Fourth Circuit in *Ourisman v. Commissioner*, *supra*, and *Frink v. Commissioner*, 798 F.2d 106 (4th Cir. 1986), pet. for cert. pending No. 86-1151 (filed Jan. 13, 1987) and (b) the decisions of the Fifth Circuit in *Roccaforte v. Commissioner*, 708 F.2d 986 (5th Cir. 1983) and *George v. Commissioner*, 803 F.2d 144 (5th Cir. 1986), petition for cert. pending, No. 86-1152 (filed Jan. 13, 1987). The Commissioner advocated the Fourth and Fifth Circuit's analysis of *National Carbide*.

INTRODUCTION AND SUMMARY OF ARGUMENT

The manifest purpose of the Federal income tax is to impose the tax upon those persons or entities that earn or otherwise create the right to receive income and enjoy its benefit when paid. *Helvering v. Horst*, 311 U.S. 112 (1940). The tax "is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." *Corliss v. Bowers*, 281 U.S. 376, 378 (1930) and *Frank Lyon Co. v. U.S.*, 435 U.S. 561 (1978). It is undisputed that the corporations held record title to the apartment complex properties, but merely holding such title, without more, does not make the corporations the real owners. In *National Carbide*, this Court specifically recognized that a corporation can serve as a true corporate agent or trustee

in handling the property and income of even its owner—principal without being taxable therefor. (*id.* at 437).

The agency agreements and related facts of the pending case established that the proprietorships and partnerships were the real owners of the apartment complex properties and that the corporations held only record title as true corporate agents. As such, the income and losses from the ownership, construction and operation of the apartment complexes belong to the appropriate proprietorship or partnership and not to the agent corporation.

This case is factually unique among the decided cases because of the number of transactions involved and the variations of ownership interest involved. Creekside, Inc. did no more for Bollinger, individually, than it did for the partnerships in which he had a non-controlling interest. This fact offers strong proof missing from the other decided cases. The agency agreements preserved the ownership interest of Peter, Hensley and Mr. Samuel Zell ("Zell") in the various apartment complexes for which Creekside, Inc. served as agent. Such individuals did not own any stock in Creekside, Inc. and relied upon the agency agreements to preserve their ownership rights. The Commissioner does not specifically address this issue and apparently assumes that these valuable ownership interests can be disregarded because (a) Creekside, Inc. was not compensated for serving as an agent and (b) it may be questionable whether the agency relationship would have been sufficient to comply with the Kentucky usury laws. (Pet. Br. 26-36).

The facts with respect to the Cloister Apartments are also unique. On January 4, 1974, Zell purchased an 81%

partnership interest in the Cloister Partnership, but he did not purchase an interest in the agent corporation, Cloisters, Inc., which corporation was owned equally by Bollinger and Martin. This relationship continued until December 31, 1974. (Pet. App. 2a-3a n.1, 180). During the entire period, Zell's ownership interest in the Cloister Apartment complex was evidenced and preserved by the agency agreement between the partnership and Cloisters, Inc.

The agency agreements evidenced and preserved substantial ownership rights and reflected the substance of the relationships. There is no valid or logical reason to disregard these agreements.

The Commissioner states the issue to be whether a corporation ". . . can be disregarded for federal income tax purposes on the ground that it is merely an 'agent' of the partnership or proprietorship." (Commissioner's Brief ("Pet. Br.") at I). This is not and never has been the issue. The respondents have never attempted to disregard the corporations as separate entities for federal income tax purposes. The respondents seek recognition of the corporations for what they are—viable entities which served as true corporate agents with respect to the particular transactions involved in this litigation.

If a corporation serves as a true agent with respect to a particular transaction, then the income and losses arising from that transaction belong to the principal, *ab initio*. The agency theory involved herein determines the ownership of the property and of the income and losses generated by the property and its owners. It does not seek to disregard the corporate entity or to attribute *corporate* income and losses to the shareholder.

In *National Carbide* this Court stated four relevant considerations in determining whether a true agency relationship exists, and then continued by stating that "[i]f the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case" and that the corporation's "business purpose must be the carrying on of the normal duties of an agent." (*id.* at 437). The proper interpretation and application of these concepts lie at the heart of this case.

The requirement that a corporation's "relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case" is frequently referred to as the fifth *National Carbide* factor. In the pending case, the principal was the owner of the agent with respect to only two of the apartment complexes (Creekside North and Ski Lodge) and with respect to a third (Cloisters) for a portion of the time.

The fifth factor has caused the greatest interpretive difficulty. It is frequently considered to establish an arm's length requirement, with the interpretive difficulties centering upon what must be proven in order to satisfy the "arm's length" requirement. The question then becomes how closely must the relationship reflect or conform to what one would reasonably anticipate to exist between unrelated parties dealing at arm's length. The Sixth Circuit looked to the activities performed by the agent, and if the activities are the same as one would reasonably anticipate to be performed by an unrelated agent, then the fifth *National Carbide* factor is satisfied. (Pet. App. 6a-11a). The Commissioner argues that more is required

and that the relationship must conform in every aspect with what one would reasonably anticipate to exist between unrelated parties. In this case, the Commissioner argues that the relationships fail the fifth *National Carbide* factor because there was no provision in the agency agreements for compensating the agent. The Commissioner, however, has been unable to establish that compensation is a prerequisite of a valid agency or that the absence of compensation altered or influenced in any manner the "activities" performed by the corporations for the proprietorships and partnerships. The Sixth Circuit correctly held that the Commissioner's approach elevated form over substance and that true corporate agency was the substance of the relationships involved in the pending case. (Pet. App. 6a-11a).

Creekside, Inc. and Cloisters, Inc. satisfied the criteria of true corporate agents as expressed by this Court in *National Carbide*. The limited activities performed by the corporations for the principals were consistent with the normal duties of an agent and the essential criteria of an agency relationship were present. It is particularly significant that the agency relationships were reduced to writing at the inception of the transactions involved and that the lenders and other creditors were not only aware of the agency relationship but also looked to the partners for payment. As both the Tax Court (Pet. App. 33a-34a) and the Sixth Circuit (Pet. App. 8a) found, the respondents did not seek the normal benefits of doing business in the corporate form and did not use the agency relationship as a scheme to avoid taxes. True corporate agencies existed in this case and should be recognized for federal income tax purposes. To do otherwise would write into

the tax laws a complete distortion whereby income and losses of the real owners of properties would be attributed to mere agents.

ARGUMENT

THE INCOME AND LOSSES GENERATED BY THE OWNERSHIP, CONSTRUCTION AND OPERATION OF THE APARTMENT COMPLEXES MUST BE REPORTED FOR TAX PURPOSES BY THE APPROPRIATE PROPRIETORSHIP OR PARTNERSHIP AS OWNER AND NOT BY THE AGENT CORPORATIONS.

A. A True Corporate Agent Or Trustee May Handle The Property And Income Of Its Principal Without Being Taxable Therefor.

In *National Carbide* this Court recognized, in dicta, that a true corporate agent or trustee may handle the property and income of its owner-principal without being taxable therefor. (*id.* at 437). The respondents rely upon this concept, the agency agreements and the other indicia of true agency relationships to establish that the proprietorships and partnerships were the real owners of the apartment complexes. As the real owner of the property, the applicable proprietorship or partnership is required for federal income tax purposes to report the income and losses arising from the ownership, construction and operation of the apartment complex. *Lucas v. Earl*, 281 U.S. 111 (1930); *Helvering v. Horst, supra; Moncrief v. Commissioner*, 730 F.2d 276 (5th Cir. 1984); and *Raphan v. U.S.*, 759 F.2d 879 (Fed. Cir. 1985), cert. denied, 474 U.S. 843 (1985).

B. The "Agency" Concept Recognized In National Carbide Is Compatible With The "Separate Entity" Concept Recognized In Moline Properties.

a. In *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436 (1943), this Court held that a corporation is a separate entity for federal income tax purposes if the corporation's purpose "is the equivalent of business activity or is followed by the carrying on of business by the corporation . . . ". (*id.* at 438-439).

Based upon *Moline Properties*, the respondents have consistently recognized throughout this litigation that the corporations were separate entities for federal income tax purposes, because they conducted business activity. The question is whether, with respect to the particular transactions involved in this case, the corporations served as true corporate agents thereby causing the income and losses from the ownership, construction and operation of the apartment complexes to be taxable to the proprietorships and partnerships as principals.

The Commissioner misstates the issue in this case to be whether a corporation "can be *disregarded* for federal income tax purposes on the ground that it is merely an 'agent' of the partnership or proprietorship." (Pet. Br. I, emphasis added). This is not the issue. The respondents have never sought to disregard the corporations as separate entities. The respondents seek recognition of the corporations for what they are—visible entities which served as true corporate agents with respect to the particular transactions inovlved in this litigation. The corporations are separate taxable entities, but, with respect to the

transactions involved in this case, they served as agents for their taxpayer principal.

The Commissioner's statement of the issue reflects a basic misunderstanding of the "separate entity" concept of *Moline Properties* and the "agency" concept of *National Carbide*.

In *Moline Properties* and *National Carbide* the "usual incidents of an agency relationship" were lacking, and the only evidence offered to support the alleged agency relationship was shareholder ownership and control of the corporation. The decisions in *Moline Properties* and *National Carbide* established that an agency relationship between a corporation and its shareholders cannot exist for tax purposes if the relationship is identical to the relationship that commonly exists between shareholders and their corporations. Therefore, under the agency theory, the inquiry is whether, apart from the control shareholders have of their corporation, there are indicia of agency sufficient to establish the existence of an agency relationship between the corporation and its shareholders. If a true corporate agency exists, then the income and losses from the particular transaction or transactions involved in the agency relationship belong to the principal, *ab initio*. *National Carbide v. Commissioner*, *supra*; *Moncrief v. Commissioner*, *supra*, and *Raphan v. U.S.*, *supra*.

The "agency" concept of *National Carbide* and the "separate entity" concept of *Moline Properties* are compatible rather than mutually exclusive concepts as suggested by the Commissioner's statement of the issue. They are compatible concepts because the non-taxable agent

recognized in *National Carbide* necessarily engages in business activity.

Professors Bittker and Eustice analyzed the compatibility of the "separate entity" and "agency" concepts as follows:

> . . . Although these Supreme Court decisions [*Moline Properties* and *National Carbide*] are frequently quoted in support of the theory that "business activity" is inconsistent with an agency relationship between the corporation and its shareholders, they do not fully support this theory. A better explanation of these cases is that the corporation must establish that it is an agent for its shareholders (with respect to the transactions in question) by evidence other than the control which shareholders automatically possess over their corporations. . . . B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders* (4th Ed. 1979) para. 2.10, pp. 2-28 and 2-29).

b. In *Moline Properties*, this Court briefly discussed the agency theory in response to the taxpayer corporation's alternative argument that it was merely an agent of its sole shareholder by reason of the shareholder's total control of the corporation. (*id.* at 439). The argument was rejected by this Court, because an agency contract had not been executed and "the usual incidents of an agency relationship" were lacking. (*id.* at 440).

The requirements of a true corporate agency were more specifically discussed in *National Carbide*. In that case the petitioners were three wholly-owned subsidiary corporations of Air Reduction Corporation ("Airco"). Airco entered into agency contracts with the three subsidiary corporations, which contracts provided that the subsidiaries were employed as agents to manage and operate certain production plants and to sell the output for Airco. Airco agreed to furnish working capital, executive management and office facilities. The subsidiaries agreed to pay Airco all profits in excess of six percent (6%) of its nominal outstanding capital stock. The subsidiaries held title to their assets, and the amounts advanced by Airco for working capital were carried on the subsidiaries' books as accounts payable. The directors of the subsidiaries met only to ratify the actions of Airco's top management. Airco treated the profits from the subsidiaries as its own income and reported it as such for tax purposes, whereas the subsidiaries reported only the six percent (6%) return on its nominal capital. (*id.* at 424-426). The subsidiaries claimed that they should be taxed on net income aggregating only $1,350.00, despite the fact that during the tax year (1938) they owned assets worth nearly 20 million dollars, had thousands of employees, had net sales of approximately 22 million dollars and net earnings of nearly four and one-half million dollars. (*id.* at 437). The Commissioner determined that the subsidiaries were taxable on all the income from *their* operations. The subsidiary corporations argued that they were true agents, because their relationship with Airco contained the "usual incidents of an agency relationship" as that phrase was used in *Moline Properties*. (id. at 427). The subsidiary corporations relied, in part, upon *Southern Pacific Co. v. Lowe*, 247 U.S. 330 (1918) to argue that the "practical identity" existing between a parent corporation and its subsidiary corporations established, *ipso facto*, an agency relationship. (*id.* at 427). The argument was rejected by this Court as a misinterpretation of *Southern Pacific*. (*id.* at 429). This Court stated that "[c]omplete ownership

of the corporation, and the control primarily depended upon such ownership—the important ingredients in the Southern Pacific Case—are no longer of significance in determining taxability" (*id.* at 429), and continued by stating that "[o]wnership of a corporation and the control incident thereto can have no different tax consequences when clothed in the garb of agency than when worn as a removable corporate veil." (*id.* at 430). The Court reaffirmed *Moline Properties* by stating that "[w]hen we referred to the 'usual incidents of an agency relationship' in the Moline Properties Case, we meant just that—not the identity of ownership and control disclosed by the facts of this case." (*id.* at 439). In *National Carbide*, this Court carefully limited its analysis by stating as follows:

> . . . What we have said does not foreclose a true corporate agent or trustee form handling the property and income of its owner-principal without being taxable therefor. Whether the corporation operates in the name and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists. If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case. Its business purpose must be the carrying on of the normal duties of an agent. *Id.* at 437, footnotes omitted).

National Carbide presented a particularly abusive circumstance. The subsidiary corporations had earned the income in question and, through the agency agreements, had anticipatorily assigned to Airco all but a nominal

amount of the income. The so called agency agreements were an attempt to circumvent an established body of tax law "requiring that income be taxed to those who earn it, despite anticipatory agreements designed to prevent vesting of the income in the earners . . . " (*id.* at 436). The agreements in *National Carbide* lacked substance, because the underlying relationship lacked the usual incidents of an agency relationship. (*id.* at 437-439).

c. The Commissioner argues that "[i]n *National Carbide*, the taxpayers made the same basic contention as respondents here—namely, that even though certain corporations were viable separate entities, the tax consequences of *their* operations were not attributable to them because they acted merely as 'agents' of their common parent corporation." (Pet. Br. 19, emphasis added). This is not and never has been the respondents' argument. In *National Carbide* the subsidiary corporations earned the income at issue and the purpose of the "agency" agreements was to anticipatorily assign the income to Airco, the parent corporation. The so-called agency relationship was nothing more than a manifestation of shareholder control and was not the type of relationship that would exist independently of shareholder control. A true corporate agency does not cause *corporate* income or loss to be attributed to its shareholders. If a true corporate agency exists, then the income and losses from the particular transaction or transactions involved in the agency relationship belong to the principal, *ab initio*. The respondents do not rely upon the agency agreements to anticipatorily assign income and losses, but rather they rely upon the agency agreements, in conjunction with the other facts of this case, to establish that the proprietorships and partnerships were the real

owners of the apartment complexes and, therefore, the real owners of the income and losses at issue.

d. The Commissioner erroneously attributes to the Sixth Circuit a misunderstanding of the interrelationship between the "separate entity" concept of *Moline Properties* and the "agency" concept of *National Carbide*. Without any citation to the Sixth Circuit's opinion, the Commissioner erroneously states as follows:

> . . . Relying on *National Carbide Corp. v. Commissioner*, 336 U.S. 422 (1949), the court of appeals stated that this supposed principal-agent relationship superseded the *Moline Properties* "separate entity" rule. Even if the two corporations were viable separate entities, the court concluded, their income and expenses could thus be attributed directly to Bollinger and his partners under an agency theory. (Pet. Br. 18)[3]

The Sixth Circuit neither stated nor inferred that a true corporate agency relationship supersedes the "separate entity" rule of *Moline Properties* or that *corporate* income and losses were attributable to the respondents. The Sixth Circuit precisely understood the issue. If a true corporate agency exists, then the proprietorships and partnerships were not only the beneficial but also the real owners of the apartment complexes and, as such, taxable upon the income and losses arising from the ownership, construction and operation of said complexes. (Pet. App. 5a-6a).

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[3]The Commissioner made a similar misstatement at page 17 of his brief.

C. The Relationship Between The Corporations And The Applicable Proprietorship Or Partnership Satisfies The Requirements Of A "True Corporate Agency."

The above quoted dictum from *National Carbide* is frequently considered to have stated six factors to be considered in determining whether a true corporate agency exist. The first four factors have caused little problem in their interpretation or application and were described by the Court as " . . . some of the relevant considerations in determining whether a true agency exists". (*id.* at 437). The so-called fifth factor—whether the corporation's relations with its principal are dependent upon the fact that it is owned by the principal, if such is the case (*id.* at 437) —and, to a lesser extent, the sixth factor—whether the corporation's business purpose is the carrying on of the normal duties of an agent (*id.* at 437)—have caused more confusion and conflict in their application.

National Carbide is the most recent statement by this Court concerning the facts and circumstances under which a closely held corporation may, as a true corporate agent, handle the property and income of its shareholders without being taxable therefor. For this reason the lower courts have relied heavily upon *National Carbide* in deciding the type of issue presented by this case. There is certainly no indication in *National Carbide* that the above quoted dicta was intended either to be an exhaustive statement of the relevant considerations or to establish a factor checklist to be applied in every case. However, in the pending case, neither the Commissioner, the respondents, the Tax Court nor the Sixth Circuit have offered for consideration any

factors not either specifically mentioned or at least indicated by the above quoted dicta in *National Carbide*.

There is, however, a basic distinction between *National Carbide* and the pending case. The Sixth Circuit recognized the basic distinction by stating that "it is readily apparent that the purported agency relationship in *National Carbide* could not have existed in the absence of ownership and control of the subsidiary" (Pet. App. 7a), whereas, in the pending case "[a] corporation unrelated to the principals could just as well have been entrusted to hold nominal title to avoid usury problems, while the principals retained the real and beneficial functions of property ownership." (Pet. App. 8a).

1. The Relationship Between The Corporations And The Proprietorships And Partnerships Satisfies The Four "Relevant Considerations" Stated In National Carbide.

The first four so-called *National Carbide* factors were described by the Court as "relevant considerations."[6] (*id.* at 437). The Tax Court analyzed each of these factors in detail and found them to have been satisfied in this case. (Pet. App. 29a-31a). The Sixth Circuit considered these factors but not in the individualized manner employed by the Tax Court. (Pet. App. 6a).

Therefore, with respect to the transactions involved in this case, it is accepted (a) that the corporations operated in the name and for the account of the proprietorships and

[6]The Commissioner has questioned the relevancy of factors one and three. (Pet. Br. 26).

partnerships, (b) that the corporations bound the proprietorships and partnerships by their actions, (c) that the corporations transmitted money received by them to the proprietorships and partnerships and (d) that the receipt of the income at issue is attributable to the services of employees of the proprietorships and partnerships and to assets belonging to said proprietorships and partnerships. (*National Carbide*, 336 U.S. at 437).

2. The Relationship Between The Corporations And The Proprietorships And Partnerships Was Not Dependent Upon Ownership Of The Former By The Proprieships Or Partnerships.

a. The so-called "fifth *National Carbide* factor" provides that "[i]f the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case." (*National Carbide*, 336 U.S. at 437). The factor is material to this case only with respect to the two proprietorships (Creekside North and Ski Lodge) and, to a limited extent, the Cloister Partnership, because they are the only entities that had ownership control of the agent corporation.

The lower courts have frequently analyzed the fifth factor as interposing an "arm's length" requirement.[7] Since this Court recognized in *National Carbide* that a wholly owned corporation can serve as a true agent for its owner-principal, the fifth factor cannot contemplate that an arm's length relationship must literaly exist, because a closely held corporation cannot literally deal at arm's

[7]The cases are cited and discussed in Argument E of this brief.

length with its shareholders. By definition, each party to an arm's length transaction "must be in a position to distinguish his economic interest from that of the other party and, where they conflict, always choose that to his beneficial benefit." *Creme Manufacturing Co., Inc. v. U.S.*, 492 F.2d 515, 520 (5th Cir. 1974).

The question, therefore, becames whether the relationship "conforms to" or "reflects" an arm's length relationship. The respondents understand this concept to recognize that even though related entities cannot literally deal at arm's length, they can, nevertheless, enter into relationships which are in substance the same type of relationships into which unrelated parties might reasonably be expected to enter. Significantly, this is the standard applied by the Sixth Circuit in affirming the Tax Court's decision (Pet. App. 7a-11a) and the standard now relied upon by the Commissioner to seek reversal.[8] (Pet. Br. 12-13, 24-26).

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[8]The Commissioner argued to the Sixth Circuit that the respondents' evidence must establish that the agency relationship was, in fact, an arm's length arrangement. (Pet. App. 9a). The Commissioner's argument was based upon several recent decisions of the Fourth and Fifth Circuits, which decisions the Commissioner analyzed in his brief filed herein as holding that "if the same parties control both entities, the *National Carbide* arm's-length requirement will not be met even if the precise ownership percentages are different." (Pet. Br. 35 at n.12). This type of analysis was properly rejected by the Sixth Circuit (Pet. App. 9a-11a), because it cannot be reconciled with this Court's acknowledgment in *National Carbide* that a true corporate agent or trustee can handle the property and income of its owner-principal without being taxable therefor. *National Carbide*, 336 U.S. at 437. Although remnants of the Commissioner's "ownership" analysis of the fifth factor appear at pages 28-29 of his brief, the Commissioner has, for the most part, now moved to the same standard adopted by the Sixth Circuit, but he advocates a more restricted interpretation of the standard.

The difference in the two approaches rest with the concept of substance over form. More specifically, the difference involves the question of how closely the relationship must reflect or conform to what one would reasonably anticipate to exist between unrelated parties dealing at arm's length.

The Sixth Circuit looked to the *activities* performed by the agent, and if the activities were the same as one would reasonably anticipate to be performed by an unrelated agent, then the fifth *National Carbide* factor is satisfied. In the context of this case, the Sixth Circuit recognized that "it cannot be said that the agency relationship . . . was dependent upon the fact of common ownership and control, *in the sense that* in the absence of common ownership and control an agent would not assume the duty of holding nominal title, and a principal would not entrust that duty to an agent." (Pet. App. 8a, emphasis added). The Sixth Circuit continued by stating that "[a] corporation unrelated to the principals could just as well have been entrusted to hold nominal title to avoid usury problems, while the principals retained the real and beneficial functions of property ownership." (Pet. App. 8a).

The Commissioner argues that more is required and that the relationship must not be "inconsistent" with what one would reasonably expect to exist between unrelated entities. (Pet. Br. 30, 34). The Commissioner argues that the relationships in this case are "inconsistent" because no provision was made in the agency agreements for compensating the agent. (Pet. Br. 30, 36). The Commissioner fails to recognize that a true agency can exist without compensation to the agent. *Restatement (Second) of Agency*, Sec. 16 (1958). Perhaps even more importantly, the Commissioner failed to establish that the absence of com-

pensation altered or influenced in any manner the "activities" that the corporate agents performed in this case for their principals.

The substance of what the corporations did for the proprietorships and partnerships is unaffected by whether or not the corporations were compensated. Since compensation is unrelated to the substance of what the corporations did as agents, the Commissioner's "compensation" argument is nothing more than an attempt to elevate form over substance.

b. The pending case is factually unique, because it requires the fifth *National Carbide* factor to be considered in the context of an agent corporation which performed exactly the same services for its sole shareholder as it did for partnerships lacking ownership control. Creekside, Inc. performed the same services for Bollinger as it performed for partnerships in which Bollinger had partnership interest ranging from 66⅔% to 33⅓%.

The facts with respect to Cloisters, Inc. also present a factually unique circumstance. That transaction started in a somewhat routine pattern when Cloisters, Inc., a wholly owned corporation of Bollinger and Martin, agreed to serve as agent for the Cloister Partnership, a wholly owned partnership of said individuals. (Pet. App. 2a-3a n.1, 18a). This relationship continued from July 15, 1973 to January 4, 1974.[9] On January 4, 1974, Bollinger and

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[9]When the Commissioner reproduced the Sixth Circuit's opinion for purposes of the appendix, the date "7/15/73" was erroneously typed "7/15/74". (Pet. App. 2a-3a, n.1). The correct date is 7/15/73. (Pet. App. 18a and *Bollinger* v. *Commissioner*, 807 F.2d 65, 66 (6th Cir. 1986).

Martin sold a combined 81% partnership interest in the Cloister Partnership to Zell, who did not purchase any stock in Cloisters, Inc. From January 4, 1974 to December 31, 1974, Cloisters, Inc. continued to hold record title to the Cloister Apartments as agent for the Cloister Partnership. On December 31, 1974 Cloisters, Inc. transferred record title to the Cloister Apartments property to Greenland Vista, Inc., a nominee corporation in which the respondents had no interest. (Pet. App. 2a-3a at n.1, 18a). Therefore, from January 4, 1974 to December 31, 1974 Cloisters, Inc., a wholly owned corporation of Bollinger and Martin, served as agent for the Cloister Partnership, a partnership in which Zell owned an 81% partnership interest.

Peter, Hensley and Zell did not own any stock in Creekside, Inc. or Cloisters, Inc. They relied upon the agency agreements to evidence and preserve their respective ownership rights in the apartment complexes. The Commissioner does not specifically address this issue and apparently assumes that these valuable ownership interests can be disregarded because (a) the corporations were not compensated for serving as an agent and (b) it may be questioned whether the agency relationships were sufficient to comply with the Kentucky usury laws. (Pet. Br. 26-36). The agency agreements evidenced and preserved substantial ownership rights and reflected the substance of the relationships. There is no valid or logical reason to disregard them.

Recognizing that the fifth *National Carbide* factor is material only if ownership control exists, the Commissioner argues that the partnerships for which Creekside, Inc.

served as agent must be considered as controlled by Bollinger. The Commissioner asserts that the disparity in stock holding "was largely illusory", because Bollinger was the "dominate voice in all the partnerships". (Pet. Br. 29-30 and n.9). The argument is not supported by the record or by findings of the Tax Court. The partnership agreements provided that each partner had an equal vote in the affairs of the partnership,[10] which is true for even the Carriage Hill Partnership in which Bollinger had a 66⅔% partnership interest. Peter, Hensley, Zell and Martin were experienced in the real estate development business,[11] and, even though Bollinger may have been the moving force, there is absolutely nothing in the record to support the Commissioner's assertion that Bollinger was also the controlling force.

Alternatively, the Commissioner argues that there was common control because Bollinger's partners should be considered as "constructively" owning a ratable portion of Creekside, Inc.'s stock. (Pet. Br. 10, 29 n.8). The argument must fail because it is contrary to the Tax Court's factual finding that Creekside, Inc. was wholly owned by Bollinger. (Pet. App. 18a, 20a, 31a). Additionally, the three cases cited by the Commissioner in support of the argument are totally distinguishable and do not even address the issue. In the first case, *Commissioner v. Fink*, No. 86-511 (June 22, 1987), slip op. 5, this Court held that the dominate shareholders of a closely held corporation who surrender some of their shares to the corporation are not entitled, in the year of surrender, to an ordinary loss deduction for the full amount of their adjusted basis in the surrendered shares, but rather, the adjusted basis in said shares is to be added to the basis of the remaining shares. In the second case, *Interstate Transit Lines v. Commissioner*, 319 U.S. 590 (1943), a parent corporation attempted to deduct an amount paid to its subsidiary corporation to offset an operating deficit incurred by the subsidiary. This Court disallowed the deduction, because it was not paid or incurred in carrying on the parent corporation's business and declined to characterize the payment. In the third case, *Deputy v. du Pont*, 308 U.S. 488 (1940), this Court held that certain sums paid by the taxpayer with respect to certain corporate stock for the broad purpose of conserving and enhancing his estate were not deductible as either ordinary and necessary business expenses or interest expense and declined to speculate as to the proper treatment of said sums for federal income tax purposes. Neither *Fink*, *Interstate Transit* nor *du Pont* involved in any manner the issue of constructive stock ownership by third parties.

[10]The partnership agreements appear in the record as Exhibits 48-AS (Carriage Hill), 69-BI (Creekside South), 97-CA (Les Chateaux), 117-CL (Lamplighter), 144-DF (Two Lakes), 177-DW (Cloisters), 185 (Cloisters, amended 1/4/74). The exhibits were offered and received into evidence as part of the Stipulation of Facts. (Tr. 5-8).

[11]The work experience of said individuals is stated, generally, in the transcript at Tr. 35-36 (Hensley), Tr. 82-84 (Peter), Tr. 98-107 (Zell) and Tr. 112 (Martin).

The partnerships for which Creekside, Inc. served as agent were not controlled by Bollinger. Therefore, the fifth *National Carbide* factor is not even relevant to these partnerships.

c. Irrespective of whether the fifth factor is relevant to some of the partnerships, it has been satisfied. The factor demands an evaluation of the activities performed

by the agent to determine if they are the same type of activities that an unrelated agent would reasonably be expected to have performed. If they are, then the relationship is not dependent upon ownership control.

The Commissioner's only challenge is the lack of compensation, and an argument that the agency would not be successful in complying with the Kentucky usury statutes. Neither argument is relevant. The "compensation" argument has been previously discussed in this brief. The "success" argument will be discussed under the next sub-argument heading.

3. The Business Purpose Of The Corporations Was The Carrying On Of The Normal Duties Of An Agent.

a. The so-called "sixth *National Carbide* factor" provides that a true corporate agent's "business purpose must be the carrying on of the normal duties of an agent." (*id.* at 437). In the pending case, both the Tax Court and the Sixth Circuit held that the corporations carried on the normal duties of an agent. (Pet. App. 6a-11a, 32a-34a). The intended purpose of the agency agreements was to establish the applicable proprietorship or partnership as the real owner of the apartment complexes and to reduce to writing the agreement whereby the corporations would hold record title to the properties solely for the purpose of obtaining construction and permanent financing. (Pet. App. 20a, n.4; 22a, 24a).

The Commissioner's only argument in response is that the requirements of the Kentucky usury law would not have been complied with if the corporations acted as agents rather than principals. (Pet. Br. 27). In response,

the respondents state (a) that the Commissioner has failed to establish that the agency relationship was not sufficient to comply with the Kentucky usury law and (b) since both the lender and the borrower were aware of the agency relationship, it should be of no concern in this federal income tax case whether the form in which lenders required the transaction to be structured was sufficient to achieve their purposes under the Kentucky usury law.

b. The Commissioner has not cited any Kentucky authority to support his assertion that the Kentucky usury law would not be complied with if a corporation held only record title to the property while the real and beneficial ownership remained in certain individuals or partnerships. When financing was obtained for the transactions involved in this case, interest in excess of seven percent (7%) per annum on such loans was usurious under Kentucky law. (Kentucky Revised Statutes ("K.R.S.") 360.-010). Corporations, however, were barred from raising the defense. (K.R.S. 360.025). The defense of usury was not available to individuals who guaranteed corporate debts. *E'town Shopping Center, Inc. v. Lexington Finance Co.*, 436 S.W.2d 267 (Ky., 1969). In 1972 Kentucky Revised Statute 360.010 was amended to remove all restrictions on the rate of interest for loans of the type and in the amounts involved in this case. (K.R.S. 360.010, effective March 30, 1972).

An analysis of the foregoing Kentucky law reflects little, if any, public policy concern for the business type loans involved in this case. As an example, consider a loan made upon the sole security of a tract of land known as Blackacre and the personal assets of an individual, Mr. X. If the loan had been made to Mr. X, and secured by a

mortgage on Blackacre, then the defense of usury was available. If the loan had been made to a corporation which had no assets other than Blackacre and if the loan had been secured by a mortgage on Blackacre and the personal guarantee of Mr. X, then the loan was not subject to the defense of usury even though Mr. X's personal exposure would have been the same.

If the usury defense had been raised with respect to one or more of the transactions involved in this case, it would fall between the two examples discussed above. It would present a situation in which the loan was made in the name of a nominee corporation without designation of an agency relationship in the loan papers but with the parties being aware of the agency relationship. Counsel for the respondents are not aware of any Kentucky cases considering this issue, but it not unreasonable to expect a Kentucky court to hold that the defense of usury was not available because the corporation, even though it acted as an agent, had primary liability for repayment of the loan because the agency was not disclosed in the negotiable loan documents. See *Restatement (Second) of Agency*. Secs. 4, 186-193 (1958).

b. The state law issue of whether the lenders successfully structured the loans so as to accomplish their non-tax purpose of avoiding the usury defense should not be determinative of whether the corporation was acting as agent. The significant fact in the pending case is that "[t]he lenders were all fully aware that the corporations were acting as an agent of the partnerships and merely holding legal title to the property in order to satisfy the lenders' financing requirements." (Pet. App. 33a). The substance of the transactions was an agency relationship,

and the lenders were aware of the agency relationship. The purposes of the agency were consistent with the normal duties of an agent. *Moncrief v. Commissioner, supra,* and *Raphan v. U.S. supra.*

D. The Respondents' Analysis Of National Carbide Is Supported By The Decisions Of The Lower Courts.

The Commissioner petitioned this Court for a writ of certiorari on the grounds that the opinion of the Sixth Circuit in this case conflicts with decisions of the Fourth Circuit in *Ourisman v. Commissioner, supra,* and *Frink v. Commissioner, supra,* and with decisions of the Fifth Circuit in *Roccaforte v. Commissioner, supra,* and *George v. Commissioner, supra.*

Earlier decisions involving this issue were litigated either solely or primarily on the question of whether the corporate entity could be disregarded.[12] This is not the theory involved in the pending case and will not be further discussed.

The recent history of this issue commenced with the Tax Court's decision in *Roccaforte v. Commissioner,* 77 T.C. 263 (1981), rev'd, 708 F.2d 986 (5th Cir. 1983). In that case, there was initial identity of ownership between the

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[12]See *Crouch v. United States,* 692 F.2d 97, 99 (10th Cir. 1982); *Ogiony v. Commissioner,* 617 F.2d 14 (2d Cir. 1980); cert. denied 449 U.S. 900 (1980); *Evans v. Commissioner,* 557 F.2d 1095, 1099 (5th Cir. 1977); *Lane v. United States,* 536 F. Supp. 397, 401 (S.D. Miss. 1981); *Collins v. United States,* 386 F. Supp. 17 (S.D. Ga. 1974), aff'd per curiam 514 F.2d 1282 (5th Cir. 1975); *Strong v. Commissioner,* 66 T.C. 12 (1976), aff'd without published opinion 553 F.2d 94 (2d Cir. 1977); *Bolger v. Commissioner,* 59 T.C. 760, 766 (1973).

purported principal and agent. Additional investors subsequently purchased an interest in the purported principal but not in the purported agent. At all times, the controlling partners in the purported principal had ownership control of the purported agent. In a Court reviewed opinion, the Tax Court analyzed the so-called fifth *National Carbide* factor by looking primarily at the principal's ownership control of the agent and concluded that "[i]t would be difficult to hold that the corporation and the partnership dealt with each other at arm's length." (*id.* at 287). The Tax Court, however, did not consider the fifth *National Carbide* factor to be mandatory, proceeded to evaluate the entire substance of the relationship and found a true corporate agency to exist. (*id.* at 287-288).

The Commissioner appealed the *Roccaforte* decision to the Fifth Circuit. In reversing, the Fifth Circuit accepted the Tax Court's analysis of the fifth factor (*id.* at 989) but held the factor to be "mandatory" (*id.* at 989-999), thus necessitating reversal of the Tax Court. Absent from the Fifth's Circuit's opinion is the separate analysis of the substance of the transaction, which was, presumably, rendered moot by the Fifth Circuit's analysis of the fifth factor.

The respondents submit that the Tax Court reached the correct result in *Roccaforte* but, for reasons previously discussed in this brief, the respondents differ with the Tax Court's "ownership" rather than "activity" analysis of the fifth *National Carbide* factor. The Tax Court engaged in analysis of the "activity" relationship but did so in the overall evaluation of the substance of the relationship. The restricted analysis of the fifth factor was of little consequence, because the fifth factor was not treated by the Tax

Court as being mandatory. The circumstances changed drastically when the Fifth Circuit accepted the "ownership" analysis but held the fifth factor to be mandatory. The Fifth Circuit held, therefore, that if the principal has ownership control of the agent, then a true corporate agency cannot exist even though this Court stated in *National Carbide* that nothing said therein was to "foreclose a true corporate agent or trustee from handling the property and income of its owner-principal without being taxable therefor." (*id.* at 437).

The Fifth Circuit next considered this type of issue in *Moncrief v. U.S., supra.* In that case, the purported principal did *not* have ownership control of the purported agent, and Fifth Circuit held that a true agency existed. (*id.* at 278-279, 283). The Fifth Circuit in *Moncrief* found a "tension" between the fifth factor and this Court's statement in *National Carbide* that a true corporate agent or trustee can handle the property and income of its owner-principal without being taxable therefor. (*id.* at 283). The "tension" arises not from this Court's analysis in *National Carbide* but from the Fifth Circuit's erroneous analysis and mandatory application of the fifth factor. The Fifth Circuit left the "tension" unresolved, because the absence of ownership control satisfied the requirement of the fifth factor. (*id.* at 283).

The Tax Court next considered this type of issue in *Ourisman v. Commissioner, supra,* which case was decided a few months prior to the Fifth Circuit's decision in *Moncrief.* In *Ourisman,* the interest of the individuals in the corporation and the partnership coincided. In another Court reviewed opinion, the Tax Court reconsidered its position in view of the Fifth Circuit's reversal in *Rocca-*

forte and decided that its analysis in *Roccaforte* was correct. Under the same type of analysis, the Tax Court held that the fifth factor was not satisfied but that the substance of the relationship was a true corporate agency. (*id.* at 184-188).[13]

In *Ourisman*, the Tax Court re-examined its prior holding that the fifth factor was not mandatory. The Tax Court realized that mandatory application of its "ownership" analysis of the fifth factor would frustrate the purposes of *National Carbide*. The Tax Court observed that "[t]he one crucial question under *National Carbide* concerns the essential nature of the relationship between the purported corporate agent and its shareholders" (*id.* at 185), and continued by stating that "[t]here is no indication that the Court [in *National Carbide*] intended to deny a corporation the status of agent for its shareholders in spite of the presence of the indicia of agency (factors one through four) merely because the agency is to some extent based upon the shareholders' control of the corporation (factor five)." (*id.* at 186). The Tax Court concluded that "the taxpayer must prove that the agency existed independently of the shareholders' ownership and control." (*id.* at 185-186). The respondents agree with the Tax Court's analysis, but are of the opinion that most of such analysis should be made as part of an "activity" analysis of the fifth factor rather than as part of an analysis of the overall substance of the transaction.

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[13]The concurring opinions of Judges Swift and Hamblen observe that the majority opinion in *Ourisman* as well as the Fifth Circuit in *Roccaforte* "place excessive emphasis on the ownership of the corporate agent by the principal in evaluating this [fifth] factor." (*Ourisman*, 82 T.C. at 188).

The Commissioner appealed the *Ourisman* decision to the Fourth Circuit. In reversing, the Fourth Circuit determined that the fifth factor is mandatory and that it must be given "literal effect." (*id.* at 547). The Fourth Circuit speculated that a controlled corporation serving as a purported agent of its shareholders "might" be able to satisfy the fifth factor "if it can be shown that the agency relationship *reflects* an arm's length arrangement between the principal and agent", but the Court held against the taxpayer in *Ourisman* because "the corporation and partnership did not bargain at arm's length." (*id.* at 548, emphasis added). The Fourth Circuit noted that the Tax Court had found (a) that "the corporation's relations with the partners were based to some extent upon the control the partners exercised over the corporation as shareholders", (b) that "the partners' interests in the corporation coincided with the partners' interests in the partnership", (c) that "the corporation acted solely for the partnership and received no compensation for its services" and (d) that the corporation and the partnership did not bargain at arm's length. (*Ourisman*, 760 F.2d at 548). The Fourth Circuit accepted these findings but found them to establish that the "mandatory" fifth factor was not satisfied. (*id.* at 548).

Considerations (a), (b) and (d) all relate to an "ownership" analysis of the fifth *National Carbide* factor. Consideration (c) relates to neither an "ownership" nor an "activity" analysis and is directed, at best, to the form of the relationship. The compensation argument has been previously discussed in this brief. The fact that the

corporation acted solely for the partnership cannot be a controlling consideration. Obviously, a corporation, whether controlled or not, is not required by any concept of agency law to serve at least two principals before it can qualify as a true corporate agent.

The Tax Court next considered this type of issue in the pending case and then in *Frink v. Commissioner*, 49 T.C.M. (CCH) 386 (1984), rev'd 798 F.2d 106 (4th Cir. 1986), pet. for cert. pending, No. 86-1151. In *Frink*, all the stock of the corporation ("Argo") was owned by Mr. Yemelos and his wife. (*id.* at 389, 398). Mrs. Yemelos held no interest in the partnership ("Casren") or its successor ("BHPP"). (*id.* at 398). During the years at issue, Mr. Yemelos' interest in the partnership (including the successor) started at 80% in 1975 and decreased to 61.76% by 1977. In *Frink*, the Tax Court applied the same type of analysis it employed in *Roccaforte* and *Ourisman*, and found a true agency to exist with respect to Argo. (*id.* at 399). With respect to the fifth *National Carbide* factor, the Tax Court stated that, while "not free from doubt", it was "persuaded on balance that the relationship of Argo . . . to Casren and BHPP was not dependent upon the ownership and control of the former . . . entit[y] by the latter two entities." (*id.* at 398). Thus, the Tax Court held that the fifth *National Carbide* factor had been satisfied.

The Commissioner appealed the Tax Court's decision in *Frink*. The appeal went to the Fourth Circuit (*Frink v. Commissioner, supra*) and to the Fifth Circuit (*George v. Commissioner, supra*). The Fourth Circuit rendered the first opinion on appeal.

In reversing, the Fourth Circuit in *Frink* stated that the principals explained by it in *Ourisman* governed the decision and, accordingly, held against the taxpayer on this issue. (*Frink*, 798 F.2d at 109).

In reversing, the Fifth Circuit in *George* accepted, for the purposes of its opinion, "that Argo [the corporation] acted as agent for BHPP [the partnership] and not in its own name in developing the hotel site". (*id.* at 147-148). The court confined its opinion to "the question of whether that agency relationship depended on Yemelos's ownership of BHPP and Argo." (*id.* at 148). The Fifth Circuit reaffirmed its prior holding that the fifth factor is mandatory (*id.* at 148), and stated that in order to satisfy the fifth factor the "taxpayers must prove that Yemelos and BHPP dealt with Argo at arm's length". (*id.* at 148). Even though the Fifth Circuit accepted as fact the existence of a corporate agency, it refused to recognize the agency for tax purposes because (a) Yemelos controlled Argo (*id.* at 148), (b) Yemelos made no provision in the nominee agreement for compensating Argo and ultimately paid only $100.00 to Argo when the evidence established that an unrelated entity known as Conduit, Inc. would have charged $1,000.00 (*id.* at 148-149) and (c) Argo did not act as agent for anyone other than Yemelos. (*id.* at 149).

Considerations (b) and (c) cannot be determinative of the issue for the reasons previously stated. The Fifth Circuit, therefore, based its decision in *George* upon an "ownership" rather than an "activity" analysis of the relationship between the purported principal and agent for purposes of the fifth *National Carbide* factor.

The Fourth and Fifth Circuits have interpreted the fifth factor as involving an "ownership" rather than an

"activity" analysis of the relationship between the principal and agent. The Commissioner has reached a similar conclusion with respect to his analysis of the decisions from the Fourth and Fifth Circuits. (Pet. Br. 35, n.12). The two circuits have misapplied the fifth factor and have, as a practical matter, foreclosed what this Court in *National Carbide* stated was not to be foreclosed. This is precisely the reason the Sixth Circuit refused to accept this line of reasoning. (Pet. App. 9a-11a).

The Federal Circuit has recently considered this type of issue in *Raphan v. U.S., supra.* In that case the purported principal did not have ownership control of the purported agent. (*id.* at 881-882). The purported agent was used to comply with state usury statutes, and the Federal Circuit found a true corporate agency to exist. (*id.* at 883-884). Also see *Vaughn v. U.S.*, 740 F.2d 941 (Fed. Cir. 1984).[14]

e. Unlike the Fourth and Fifth Circuits, the Sixth Circuit correctly interpreted the fifth factor as requiring an analysis of the "activity" involved and not merely the "ownership" involved. (Pet. App. 8a). The Sixth Circuit recognized that in the context of controlled corporations, the relationship between the principal and agent will depend to a certain degree upon such control, but that this fact by in itself is not sufficient to foreclose a true corporate agency.

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[14]Other frequently cited cases involving the agency issue in a context other than state usury statutes are *Carver v. United States*, 412 F.2d 233 (Ct. Cl. 1969); *Harrison Property Management Co. v. U.S.*, 475 F.2d 623 (Ct. Cl. 1973), cert. denied, 414 U.S. 1130 (1974) and *Stillman v. Commissioner*, 60 T.C. 897 (1973).

E. Recognizing The Corporations As True Agents Is Consistent With Underlying Policy Considerations.

a. The Commissioner argues that recognizing the agency relationships in this type of case would undermine the federal tax policy considerations of Subchapter S of the Internal Revenue Code. (Pet. Br. 36-37). One of the principal purposes of Subchapter S is to permit a qualified corporation and its shareholders to elect, basically, to have the corporation's income taxed to its shareholders while the shareholders continue to enjoy the nontax benefits of doing business as a corporation. B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders* (4th Ed. 1979), para. 6.01 pp. 6-1 and 6-2. The election applies to all of the corporation's income. (26 U.S.C. Secs. 1363, 1366).

The "agency" concept recognized in *National Carbide* does not compete with and will not undermine the policy considerations of Subchapter S. This is true primarily because shareholders who use their corporation as a true corporate agent lose the normal benefits of doing business as a corporation, and, among other things, they become personally liable for the acts of the corporate agent taken pursuant to the agency. *Restatement (Second) of Agency,* Secs. 215-282 (1958). Such a result cannot undermine the purpose of Subchapter S, which is designed to reach a particular tax result while permitting the shareholders to retain the nontax benefits of doing business as a corporation.

b. The Commissioner argues that failure to require proof of an arm's length arrangement in applying the

fifth *National Carbide* factor would yield a prescription for abuse under which the separate entity regime would collapse. (Pet. Br. 34-35). The argument is based primarily upon policy considerations expressed by the Fourth Circuit in *Ourisman,* but the Fourth Circuit confined its analysis to situations in which "the agency relationship could not exist but for the shareholders' ownership and control of the corporate agent." (*Ourisman,* 760 F.2d at 549). Therefore, the policy considerations raised by the Commissioner present nothing more than the issue of the correct application of the agency concept recognized in *National Carbide.*

The Fourth Circuit in *Ourisman* stated that if a controlled corporation can be treated as a "nontaxable agent" for its controlling shareholders, then the "logical conclusion" of such a proposition is that "shareholders with impunity could take advantage of the system of separate taxation of corporations by treating their corporation as a separate taxable entity with respect to some transactions while treating the corporation as a nontaxable agent with respect to other transactions." (*id.* at 549). The conclusion does not necessarily or logically follow from the stated proposition.

As a matter of tax policy, the principal concern should be that after a transaction closes or is substantially completed the shareholders should not still have open to them the option to treat their controlled corporation as a nontaxable agent with respect to that transaction. However, to deny as a matter of policy the right of *all* controlled corporations to act as agents for their shareholders and

others is to deny or foreclose what this Court specifically stated in *National Carbide* was not to be foreclosed.

The first four *National Carbide* factors have particular relevance to this policy consideration. These factors cannot be satisfied unless the agency relationship was recognized by the shareholders and made known to relevant third parties upon commencement of the particular transaction. In the pending case, both the Tax Court and the Sixth Circuit found these factors to be satisfied, and the Commissioner has not challenged the findings.

It is obviously difficult to express standards that apply to all situations, but the respondents submit that, under the facts of this case, the corporations were true agents with respect to the apartment complexes properties primarily because:

1. Written agency agreements were executed at the inception of the transactions, which agreements established the purposes of the agency and retained in Bollinger or the partnership, as applicable, not only the beneficial but also the real ownership of the property.

2. The activities to be performed by the corporations were of the type that one would reasonably expect an unrelated agent to perform for its principal.

3. The lenders and other creditors were aware of the agency relationship and looked to Bollinger and the partners, as applicable, for payment.

4. The apartment complexes were constructed and operated by Bollinger or the partnerships, as applicable.

5. The respondents did not seek the normal benefits of doing business in the corporate form.

6. The respondents did not use the agency relationships as a scheme to avoid taxes.

The relationship between the corporations and the applicable proprietorships or partnerships bore the usual incidents of a true agency and not merely the manifestations of control that shareholders normally have over a corporation. The corporations were true agents and should be recognized as such.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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REPLY

BRIEF

FOR ARGUMENT

No. 86-1672

In the Supreme Court of the United States

OCTOBER TERM, 1987

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JESSE C. BOLLINGER, JR., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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EDITOR'S NOTE

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1. In *Moline Properties, Inc.* v. *Commissioner*, 319 U.S. 436 (1943), this Court firmly established the proposition that a corporation engaged in business activity is to be treated as a separate taxable entity. This is so even if the business activity is quite limited, and even if the corporation is a "dummy" whose financial interest is indistinguishable from that of its shareholder (see *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422, 433 (1949)). For example, in *Moline* the corporation's sole function was to hold title to certain real estate in order to facilitate the taking out of a loan. Nevertheless, the Court there held, "the taxpayer had adopted the corporate form for purposes of his own" and that choice "required the acceptance of the tax disadvantages" of having the corporation taxed as the owner of the property in question (*id.* at 439).

Respondents do not purport to challenge the validity of this fundamental rule, but their submission cannot be squared with it. Respondents acknowledge (Br. 16) that the corporations involved here "were separate entities for

federal income tax purposes, because they conducted business activity." Respondents do not specify what this business activity was, but presumably they refer to the taking out of construction loans and permanent financing and the holding of title to the properties in question, since this was the only activity in which the corporations appear to have engaged. Respondents, however, reject the necessary conclusion to be drawn from these facts—namely, that the corporations are to be taxed as separate entities with respect to this business activity. Rather, respondents contend that the business activity associated with the loans taken out by the corporations and with the operation of the property owned by the corporations is to be attributed for tax purposes directly to the partnerships; the corporations, they argue, are to be treated as separate taxable entities only in connection with other hypothetical business activity, in which they in fact did not engage (see Br. 16-17).

Respondents' argument is based on the assertion (Br. 21-22) that "the proprietorships and partnerships were the real owners of the apartment complexes and, therefore, the real owners of the income and losses at issue." Respondents do not define the term "real owners," but it is undisputed that the partnerships did not actually hold title to the properties. The corporations held record title; indeed, as respondents note (Br. 2), corporate ownership of the properties was specified by the lenders as a prerequisite for making the loans. Rather, it appears that respondents mean no more than that, because of the side agreements between the partnerships and the corporations, the partnerships were the "beneficial owners" of the properties and would be the entities that ultimately incurred gain or loss. But this fact does not alter the principle that the corporation must be taxed as a separate entity in connection with its business activities. In *Moline*, for example, this Court concluded that the corporation had to be taxed as the

owner of the property despite the lower court's specific finding (see 45 B.T.A. 647, 650 (1941)) that the sole shareholder had "[f]ull beneficial ownership" of the corporate real estate (see *National Carbide Corp.* v. *Commissioner*, 336 U.S. at 433-434).[1]

Accordingly, respondents' position here cannot be squared with the separate entity doctrine established in *Moline* and reaffirmed in *National Carbide*. Moreover, respondents' approach would severely vitiate the application of that doctrine to closely-held corporations, whose shareholders often can be characterized as the "beneficial owners" of property owned by the corporation.

2. Respondents seek to avoid the holdings of *Moline* and *National Carbide* by contending that this case falls within a narrow exception for a "true corporate agency" that is described in dictum in *National Carbide* (336 U.S. at 437). As explained in detail in our opening brief, however, respondents do not satisfy the criteria set forth in that dictum for the existence of a true corporate agency. Rather, as in both *National Carbide* and *Moline*, the attributes of agency that respondents ascribe to the relationship between the corporations and partnerships in this case merely reflect the relationship between any controlled corporation and its shareholders, and they therefore provide no basis for departing from the separate entity tax treatment ordinarily accorded to a corporation engaged in business activity.[2]

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[1] Respondents' contention is particularly weak with respect to the deductions they claim for interest paid on the construction and permanent financing. Respondents do not even assert that the partnerships were the "real" obligors on the loans. To the contrary, they note (Br. 34) that "the corporation[s] • • • had primary liability for repayment of the loan[s]." Indeed, if the partnerships had been liable for repayment of the loans, it would have been unnecessary for the bank to insist that the partners personally guarantee the loans. Thus, it is apparent that the loans were the obligations of the corporations, and, under *Moline*, the corporate entity—not the partners—was entitled to take the interest deductions.

[2] Respondents seek to distinguish *National Carbide* on the ground that it assertedly involved an attempt by the taxpaper to effect an

a. As explained in our opening brief (at 27-28), the fundamental defect in respondents' position is that the corporations here acted as principals, not as agents, and hence did not satisfy the "sixth *National Carbide* factor"—namely, that the corporation's business purpose be "the carrying on of the normal duties of an agent" (336 U.S. at 437). The purpose for which the corporations were created and used was to avoid Kentucky's usury restrictions on non-corporate borrowers. If they had acted as agents, thereby making the partnerships as principals the direct obligors of the loan, the usury restriction would not have been avoided. Hence, it was essential for purposes of obtaining the loans that the corporations be viewed as distinct entities that were the parties liable for repayment. It is undoubtedly for this reason that the corporations were not referred to as agents in any of the pertinent loan or mortgage documents. In short, as in *Moline*, the corporations were formed for a specific business purpose—here, "to gain an advantage under the law of the state of incorporation" (319 U.S. at 438)—and the taxpayers must accept the tax consequences of their choice of the corporate form.[3]

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anticipatory assignment of income earned by the corporation, while this case assertedly involves an agency relationship in which the corporation did not itself earn income or incur expenses (see Resp. Br. 21-22). But this proffered distinction simply begs the question whether there exists a true agency relationship that requires that the corporation not be treated as a separate entity. If the subsidiaries in *National Carbide* had been held to be agents, as the taxpayer contended, the income would have been earned by the parent, not by the subsidiaries, and there would have been no assignment of income. If, as the Court held, they were not agents, then the subsidiaries would have to be regarded as separate taxable entities in connection with their operations. The situation is no different here.

[3] Contrary to respondents' assertion (Br. 34-35), the fact that the lenders may have been aware of the relationship between the corporations and the partnerships cannot convert that relationship into a principal-agent relationship for federal tax purposes. As the Tax Court found (Pet. App. 33a), one aspect of the relationship of which

b. Respondents also err in contending that the relationships here satisfy the "fifth *National Carbide* factor"—namely, that the purported principal-agent relationship is not dependent upon the fact of common ownership. Respondents appear to acknowledge (Br. 26-27) that this aspect of *National Carbide* cannot be satisfied unless the taxpayer shows that the purported principal-agent relationship between the related parties reflects an arm's-length relationship. In the words of the court of appeals below, "the corporate nominee [must] conduct[ ] itself no differently than would an independent agent which had bargained with its principal for its services at arm's length" (Pet. App. 10a). But respondents quickly abandon this approach for, as we explained in detail in our opening brief (at 28-30), this arm's-length requirement plainly is not satisfied here. Bollinger clearly was the moving force in all the projects and the relationships between the corporations and the partnerships reflected his central role (see Gov't Br. 29 n.9). Moreover, the fact that the corporations received no fee at all for the valuable services they rendered surely demonstrates that the corporations and partnerships did not deal with each other as would parties at arm's length.[4]

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the lenders were aware was that the corporations were "holding legal title to the property in order to satisfy the lenders' financing requirements." That action was an assertion of principalship that was essential to the real estate transaction because of the requirements of Kentucky law.

[4] Respondents assume (Br. 28-31) that the "fifth factor" comes into play only if the ownership interests of the partnerships and the corporations are identical, and hence argue that the inquiry discussed above is relevant only to the two projects that involved sole proprietorships, plus the Cloister partnership for a portion of the relevant period. As both the Fourth and Fifth Circuits have held (see *George* v. *Commissioner*, 803 F.2d 144, 148 (5th Cir. 1986), petition for cert. pending, No. 86-1152; *Frink* v. *Commissioner*, 798 F.2d 106, 109 (4th Cir. 1986), petition for cert. pending, No. 86-1151), however, respondents' assumption is mistaken. As we explained in our opening brief (at 29-30), there need not be a complete coincidence of ownership between the corporation and its putative principal in order to give

Instead of undertaking an inquiry into whether the relationship reflects one entered into at arm's length, respondents argue that the fifth factor is satisfied so long as the activities in which the purported agent engages "are the same type of activities that an unrelated agent would reasonably be expected to have performed" (Br. 32; see also Br. 27-28, 41). This approach is plainly mistaken. First, respondents' suggested approach essentially eliminates the fifth factor from the *National Carbide* analysis because, in focusing exclusively on the general nature of the corporation's activities, it makes that factor almost identical to the sixth factor—whether the corporation is "carrying on * * * the normal duties of an agent" (336 U.S. at 437). Moreover, *National Carbide* plainly contemplates an inquiry into whether the asserted principal-agent relationship is *actually* dependent on common ownership; the Court unequivocally stated that the relationship "must not be dependent upon the fact that [the corporation] is owned by the principal" (336 U.S. at 437). Hence, that factor cannot be satisfied merely by stating that an unrelated agent theoretically could have been used. Here, there were strong reasons for the partnerships not to use an unrelated agent, such as fear that surrender of title to an unrelated party would render the property vulnerable to that party's creditors (see Gov't Br. 33 n.11). Because respondents chose to use related corporations to obtain the loans, the fifth *National Carbide* factor by its terms mandates an inquiry into whether that relationship reflects one negotiated at arm's-length; that

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rise to the dependence that is prohibited by the "fifth factor." Put another way, there is no reason to assume that a putative principal will deal with a related corporation in an arm's-length manner simply because their ownership interests are not identical. That is illustrated by this case where there can be little doubt that the relationships between the corporations and the various partnerships were orchestrated by respondent Bollinger and dependent upon his common ownership interests.

standard manifestly is not satisfied in this case. In any event, even under respondents' "activities" analysis, their principal-agent claim fails because the corporations acted as principals, not agents, in obtaining the loans (see point 2.a., *supra*).[5]

For the foregoing reasons, and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

JANUARY 1988

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[5] Respondents emphasize (Br. 7, 46) that the corporations here were not created for the purpose of obtaining tax benefits. This circumstance provides no basis for failing to have the corporations recognize the tax consequences of their business activity. The tax treatment required here by this Court's precedents is not designed to undo a tax avoidance scheme; rather, it is simply an application of the well-settled rule that the taxpayer must accept the tax consequences of the form in which he chooses to do business. This Court has never suggested that that consequence—the taxation of the corporation as a separate entity—depends on whether the taxpayer intended to use the corporation as a means to avoid taxes. Rather, the Court has quite clearly held that "the tax laws require taxation of the corporate entity if it engages in 'business activity' " (*National Carbide Corp.* v. *Commissioner*, 336 U.S. at 426).

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AMICUS CURIAE

BRIEF

(5)

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BRIEF IN SUPPORT OF RESPONDENTS BY GARY R. FRINK, ET AL. AS AMICI CURIAE

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QUESTION PRESENTED

Whether a corporate agent used by a partnership or proprietorship to hold legal title to the partnership's or proprietorship's property -- as required by lenders to obtain financing -- is taxable on income the agent received on behalf of its principal (but earned exclusively by the principal), solely because the agent is owned by some of the partners or the proprietor.

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FRANK E. LANIER
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LASSCO, INC.
Mandeville, Louisiana

ESTATE OF LEE McCORMICK
Monroe, Louisiana

LYNN ALAN MEADOWS
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MID-STATE SAND & GRAVEL CO., INC.
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Jackson, Mississippi

JOHN C. and DESPINA COSMAS YEMELOS
Manalapan, Florida

TABLE OF AUTHORITIES

In the
Supreme Court of the United States
OCTOBER TERM, 1987

No. 86-1672

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

JESSE C. BOLLINGER, JR., ET AL.,
Respondents

On Writ of Certiorari to the
United States Court of Appeals
For the Sixth Circuit

BRIEF IN SUPPORT OF RESPONDENTS BY GARY R. PRINK, ET AL. AS AMICI CURIAE

INTEREST OF AMICI CURIAE

This brief is submitted with the written consents of all parties hereto pursuant to Rule 36.2 of this Court. Amici have petitioned this Court for Writs of Certiorari to the United States

Court of Appeals for the Fourth Circuit in Frink v. Commissioner (No. 86-1151) and to the United States Court of Appeals for the Fifth Circuit in George v. Commissioner (No. 86-1152) which are identical cases involving facts indistinguishable from this case, but in which the respective Courts of Appeals found an opposite result.

STATEMENT OF THE CASE

A. The Need for a Corporate Nominee.

Unincorporated taxpayers often find it useful or necessary to transfer record title of property to a corporation[1] ("nominee") while retaining

1. The title holding corporation is often referred to as a "nominee," "dummy," "straw," "sham," "shell," "conduit," or "agent". Baker and Rothwan, Nominee and Agency Corporations: Grasping for Straws, Page 1255, 33rd Annual New York Tax Institute.

beneficial ownership (equitable title) in the property. The nominee is particularly useful where the property held for the benefit of its unincorporated principal is real property because of the title recording systems and financing practices unique to real estate.[2]

Within the context of the litany of nominee cases[3], which are indistinguish-

2. Baker, supra at 1258 to 1263; Kurtz and Kopp, The Taxability of Straw Corporations in Real Estate Transactions, 22 THE TAX LAWYER 3, at 647.

3. Roccaforte v. Comm'r., 77 T.C. 263 (1981), rev'd 708 F.2d 986 (5th Cir. 1983); Raphan v. United States, 3 Ct. Cl. 457 (1984), aff'd 759 F.2d 879 (Fed. Cir. 1985), cert. denied, 106 S.Ct. 129 (1985); Ourisman v. Comm'r., 82 T.C. 171 (1984), rev'd 760 F.2d 541 (4th Cir. 1985); Moncrief v. United States, 730 F.2d 276 (5th Cir. 1984); Frink v. Comm'r., 49 T.C.M. (CCH) 386 (1984), rev'd 798 F.2d 106 (4th Cir. 1986), petition for cert. filed (No. 86-1151); George v. Comm'r., 49 T.C.M. (CCH) 386 (1984) (Frink v. Comm'r), rev'd 803 F.2d 144 (5th Cir. 1986), petition for cert. filed (No. 86-1152); Bollinger v. Comm'r., 48 T.C.M. (CCH) 1443 (1984), (App. C, 14a) aff'd, 807 F.2d 65 (6th Cir. 1986), (App. A, 1a) cert. granted (No. 86-1672).

able from Bollinger (the matter sub judice), the reason for the use of a nominee corporation has been to comply with state usury laws in connection with the financing, acquisition, or development of real property.

The use by the non-corporate principal of the corporate nominee in these cases (hereinafter sometimes referred to collectively as "the Litany of Nominee Cases") was no more than a formalism devoid of content. Absent the use of a corporate nominee, however, the real estate project in each of these cases could not and/or would not have been undertaken. The use of a nominee corporation was required, but this was a mere happenstance.

> There is no unique feature of the corporate form that is essential to the charade. Any other silly ritual would do just as well -- say, requiring the borrower to wave a dead chicken around his head at high noon on the courthouse steps.[4]

B. Uncertain Tax Rules.

The use of a nominee corporation, while effective for the purposes outlined above, has been accompanied by significant uncertainty and inconsistency as to when the nominee can be disregarded for federal income tax purposes.

There have generally been two theories advanced that a corporation used as a vehicle for real estate investments should not be recognized for tax purposes. The first theory (the set-aside theory) questions the very ex-

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4. Miller, The Nominee Conundrum: The Live Dummy is Dead, but the Dead Dummy Should Live!, 34 TAX L.REV. 213, 269 (1979).

istence of the corporation as a taxable entity, and is buttressed on the argument that the nominee corporation is a mere sham used to hold legal, but not beneficial ownership. The Supreme Court considered this theory in Moline Properties[5], and developed the following test for determining whether a corporation should be disregarded for tax purposes:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creditor's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation,

5. Moline Properties, Inc. v. Comm'r, 319 U.S. 436 (1942).

> the corporation remains a separate taxable entity.[6]

In Moline, the taxpayer was urging that in every case of a wholly owned corporation -- regardless of ownership of assets, degree of activity, or anything else -- the corporation and the shareholder should be considered for tax purposes as a single entity.[7] This Court found that a corporation, for federal income tax purposes, is a distinct person and is taxed on its own income.

The other theory, which is applicable to the Litany of Nominee Cases, advances an agency argument: the straw corporation is merely acting as agent

6. Id. at 438-39.

7. Miller, supra at 238.

for its principals and the tax attributes derived from activities of the corporation flow to its principals. This argument was advanced in Moline, but failed in the absence of an actual contract of agency.

Subsequently, this Court in National Carbide[8] distinguished Moline because in the former case an alleged contract of agency actually did exist. While rejecting the corporate agency argument of National Carbide as lacking substance, this Court stated in dicta that a true agency relationship can exist if certain factors are present.

> What we have said does not foreclose a true corporate agent or trustee from handling the property and income of its owner-principal without being

8. National Carbide Corp. v. Comm'r, 336 U.S. 422 (1949).

> taxable therefor. [1] Whether the corporation operates in the name and for the account of its principal, [2] binds the principal by its actions, [3] transmits money received to the principal, and [4] whether the receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists. [5] If the corporation is a true agent, its relations with its principal must not be dependent upon the fact that it is owned by the principal, if such is the case. [6] Its business purpose must be the carrying on of the normal duties of an agent. 336 U.S. 422 (1949) at 437 (Emphasis added.)

The interpretation of these six factors (and most particularly factor five) have divided lower courts that have since tried to apply them.[9]

9. Supra note 3; Roccaforte, Ourisman, Frink, and George for the government; Raphan, Moncrief, and Bollinger for the taxpayer.

The issue in this litigation has not been whether to disregard the corporate form. The corporate entity has been respected because it was organized for a business purpose and carried on business activities of a nominee, thus satisfying the Moline test. The issue instead is whether the corporation will be regarded as the agent of its principals under the six National Carbide standards.

C. The Tax Court Weighs the Factors.

1. The United States Tax Court established its pro taxpayer position in the interpretation of the six National Carbide factors (and particularly the fifth factor) in Roccaforte, and has consistently maintained it through Ourisman, Frink and George, and

Bollinger[10]. Applying the National Carbide test to the facts in Roccaforte, the Tax Court found that the third factor was inapplicable, that the first, second, fourth, and sixth factors were satisfactorily established by the taxpayers, but that the fifth factor was not successfully proven.[11]

Only the fifth National Carbide factor favored the government. The Tax Court found that the corporate/partnership relationship "truly was based upon the partners' ownership and control of both entities"[12]. Further, the nominee corporation which was owned by the partners

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10. Supra note 3.

11. Roccaforte, supra note 3 at 283-287.

12. Roccaforte, supra, 77 T.C. 263, 287.

in substantially the same proportion as their ownership in the partnership, was controlled and dominated by the partners in the apparent absence of arms' length dealings between the entities.

In balancing the six National Carbide factors, however, the Tax Court found sufficient indicia of agency to conclude that a nominee relationship was present. The partners had not availed themselves of normal corporate benefits, such as limited liability. They subjected themselves to claims of creditors and others by holding themselves out as principals, and by entering a written agency agreement providing that the corporation was to act only as an agent to obtain financing. The partners were found to be owners of the realty, and

the corporation could act only upon authorization of the partners. The partners had agreed to indemnify the corporation for acts and debts relating to the project and to be liable for all loans and mortgages on the property. Various partners also provided personal guaranties of loans. There was, moreover, no effort to use the corporate form as a tax avoidance scheme; the partners had all the risks and benefits of true economic owners of the property.

2. The Tax Court in Qurisman found that four or five of the National Carbide factors were present.[13] As in Roccaforte, the Tax Court in Qurisman, addressing the fifth National Carbide factor, found the nominee corporation's

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13. Qurisman, supra, 82 T.C. 171, 183.

relations with the partners were based "to a certain extent" on the partners' control of the corporation. The corporation received no compensation, acted for no other principal, and the Court could not conclude that arm's length bargaining had taken place. The Tax Court in Ourisman specifically addressed and rejected the position adopted by the Fifth Circuit in Roccaforte and held that the Supreme Court did not intend to create a mechanical "factor checklist," with certain mandatory factors.

> The one crucial question under National Carbide concerns the essential nature of the relationship between the purported corporate agent and its shareholders ... The Supreme Court expressly recognized that a corporation could act as an agent for its owners under certain circumstances ... and specified the indicia of a true agency relationship ... When the Supreme Court stated that

> the corporation's relations with its principal 'must not be dependent upon the fact that it is owned by the principal' ... the Court was merely reiterating its holding in Moline Properties that any such agency must be proved by 'evidence other than the control which shareholders automatically possess over their corporations.' ... In other words, the taxpayer must prove that the agency existed independently of the shareholders' ownership and control. In the present case the petitioners have sustained such burden."[14]

3. The Tax Court followed Roccaforte and Ourisman in Frink and Bollinger which are presently before this Court.[15]

The position of the United States Tax Court on the agency issue requires:

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14. Ourisman, supra, 82 T.C. 171, 185-186.

15. Supra note 3.

A. A weighing of all six National Carbide factors as opposed to satisfaction of factors five and six as mandatory;

B. Looking to the "essential nature" of the relationship;

C. Finding that the fifth factor is satisfied when significant variations exist in the investors' ownership percentages in the nominee corporation and the purported principal; and

D. Relying heavily on disclosure of agency status to third parties, liabilities of principals for nominee debt and other obligations, and the absence of any purpose other than avoidance of usury limits for the formation of the corporate nominee.[16]

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16. Burke and Friel, Recent Developments in the Income Taxation of Individuals: Using the Nominee Corporation to Avoid State Usury Law Limits: The Search for a True Agent, 11 REV. OF TAX'N OF INDIVIDUALS 3, Summer 1987, 280 at 284.

D. Fourth and Fifth Circuits View Fifth National Carbide Factor as Mandatory.

1. The Fifth Circuit in rejecting the Tax Court "weighing approach" regarding the six National Carbide factors, held that the agency status could not be established if the fifth factor was not present:

> The first four conditions set out in National Carbide are general principles of agency law, and serve only as "relevant considerations" in the determination of true agency status. The fifth and sixth conditions, however, are mandatory and absolute. The plain language of National Carbide admits of no other interpretation ... The fifth and sixth conditions are not mere factors of uncertain weight; they are prerequisites which must be satisfied before a corporation can qualify as a true agent.[17]

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17. Moccaforte, supra, 708 F.2d at 986,989,990.

2. The Fifth Circuit panel in Moncrief, however, exhibited considerable disagreement with the Roccaforte analysis of the fifth National Carbide factor:

> This Circuit forbids this panel to assess the correctness of Roccaforte's construction of National Carbide as setting six "conditions" or "factors".[18]

Citing the analysis in Roccaforte, the Court continues:

> ... Roccaforte thus establishes [the fifth National Carbide factor] as a sine qua non of a true agency relationship.
>
> There is tension between this absolute and mandatory "factor" [5] and National Carbide's explicit statement: What we have said does not foreclose a true

18. Moncrief, supra note 3 at 282.

> corporate agent or trustee from handling the property and income of its owner/principal without being taxable therefor...[19]

3. More recently, in George, the Fifth Circuit reversed the Tax Court and strongly affirmed the mandatory nature of the fifth factor as an "independence requirement."[20] Under George, one of two specific tests must be met:

A. Either the principal must not own the agent; or

B. The agency relationship must not depend upon that ownership --- that is, the principal and agent must deal with each other at arm's length.

19. Moncrief, supra note 3 at 283 (footnotes omitted and emphasis added.)

20. George, supra, 803 F.2d 144.

Since in George one individual owned a majority interest of the partnership and constructively all of the putative corporate agent, the first test was not met. The Fifth Circuit in George concluded that since the nominee agreement made no provision for compensation, and the corporation acted as agent for no other principals, arm's length dealings were not present and the second test was thus not met either.

4. In reversing the Tax Court decision in Ourisman, the Fourth Circuit, like the Fifth Circuit, has rejected the Tax Court's "weighing approach," and has held that National Carbide's fifth factor is mandatory.

5. In Frink[21], the Fourth Circuit

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21. The jurisprudence in this important area has suffered from inbreeding. Judge Homer Thornberry

reversed the Tax Court's agency finding since it was largely premised on the less than complete identity of ownership in the corporation and the partnership. The Fourth Circuit found this disparity of ownership interest insufficient since the taxpayer in Frink could control the partnership with his majority interest, and there was no showing he lacked control of the corporation. The Fourth Circuit buttressed its conclusion that an arm's length relationship was not established by stressing that the agency agreement did not require payment of compensation. The court also noted that the loan documents did not disclose that

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wrote the opinions in both Roccaforte and George, and Judge John Butzner served on the panel in Ourisman and wrote the decision in Frink.

the corporation was acting as an agent, though the Tax Court had found that the lenders were well aware of the agency status.[22]

E. The Federal Circuit and the Sixth Circuit Follow the Tax Court.

1. In Raphan[23], the corporate agent was wholly owned by a family group which in turn owned 50% of the partnership principal. The Federal Circuit upheld the Claims Court on the basis that the partnership and the corporation were not commonly controlled and that the agency agreement should be given effect. The Federal Circuit held that where common control does not exist, "the concerns expressed in National Car-

22. Frink, supra, 798 F.2d 106, 110.

23. Raphan, supra, 759 F.2d 879.

bide are not applicable;" and while the agent was wholly owned by one family group, neither that family group nor the separate other family group had by itself a controlling interest in the principal --- there was, rather, a "sharing of control."[24] In the absence of common control, the Federal Circuit was prepared to respect the arm's length agency agreement that resulted -- even in the absence of the payment of a fee.[25]

2. The Sixth Circuit's affirmance of the Tax Court's finding of agency status in Bollinger (the matter sub judice) held that:

24. Raphan, id. note 23.

25. Raphan, supra at 883; See Also, Reply Brief for Appellant (U.S.) in Raphan v. U.S., 84-783 (Fed. Cir.) at page 16.

EDITOR'S NOTE

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separately taxable because under the agency agreement, it was income to the parent. In the absence of virtually every indicia of an agency relationship, in 1938, the subsidiaries collectively owned $20,000,000 of assets, had sales of $22,000,000, and earned $4.5 Million Dollars. Based on a highly dubious "agency" agreement, the subsidiaries reported total taxable income of $1,350 (based on a 6% return on the par value of outstanding capital stock).

By contrast, in the Litany of Nominee Cases including Bollinger, the corporate agent of the principal partnership or proprietorship, had no operating history prior to its appointment as agent; held only record title and not equitable title; recorded no assets or liabilities on its books; received no working capital; had no employees; and performed no services except as a nominee.

In National Carbide, the Supreme Court recited six criteria for determining whether the agent is a separate taxable entity (full quotation on pages 8 and 9 above).

The language of National Carbide is not at all inconsistent with the conclusions of the Tax Court or the Sixth Circuit below. Standard number five is the only one of the six which warrants discussion, where obviously this court was only holding that agency factors other than mere ownership must be present to find a principal/agency relationship. As was done by the United States Tax

Court and the Sixth Circuit, all of the six National Carbide criteria must be weighed based on specific facts and circumstances to determine substantively whether a genuine agency relationship exists.

2. We think it implicit in National Carbide that the agency relationship is suspect if it is motivated at least in substantial part as a device to avoid taxes. There is no tax avoidance motive suggested here. (See pages 16 and 24 above.)

3. The Fourth Circuit in Ourisman and Frink, and the Fifth Circuit in Roccaforte and George, applied the fifth National Carbide criterion in unthinking and literal terms, and held that a valid agency relationship between the cor-

porate agent and its partnership principal could not, under any circumstances, exist where the agent is owned in substantial part or totally by the principal. In so holding, however, these courts ignored the explicit statement in National Carbide that "[w]hat we have said does not foreclose a true corporate agent or trustee from handling the property and income of its owner/principal without being taxable therefor."[28]

4. In Bollinger, the Sixth Circuit applied a facts and circumstances test and the fundamental axiom of substance over form to find that the hold-

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28. National Carbide, supra at page 437. But See, Moncrief v. United States, 730 F.2d 276 (5th Cir. 1984), particularly footnote 5 at page 283, which criticizes Roccaforte for its analysis of the fifth National Carbide factor.

ing of nominal title is the kind of task customarily undertaken by an agent. Thus, an agency relationship exists, even if the agency relationship includes the fact of common ownership and control, so long as the owned agent assumed its duties in exactly the same fashion as any other unrelated agent might have done.

Several commentators anticipated the analysis in Bollinger. In their view, the position of the Internal Revenue Service appears to place undue emphasis on stock ownership of a basically worthless nominee, and inflexible adherence to the form of that nominee holding nominal title.[29] The question

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29. Kurtz, supra note 2; Miller, supra note 4; Burke, supra note 16; Meanor, The Taxation of Nominee Corporations in Real Estate Development, 5 B.U.J. OF TAX LAW 79, May 1987; Green, Recent

of the existence of a corporate nominee involves a factual determination of whether the corporate/agent is the beneficial owner of the property or is only serving as a nominal titleholder for a valid, non-tax related reason. The inquiry should not be directed towards whether a particular corporation should be disregarded for tax purposes based on stock ownership alone, but towards a factual determination of who beneficially owns the property in question, and then taxing the income from the property to the beneficial owner.[30]

Developments in the Federal Tax Law Treatment of Nominee Corporations, 13 FLA. ST. U.L. REV., page 361.

30. Bollinger, supra note 3 (6th Cir.).

5. When the substantive legal principles of Bollinger are applied to Frink and George, the result is recognition of the agent as a mere title-holding nominee for its principal. This is precisely the finding of the Fifth Circuit in George, and would have governed that case absent its interpretation of the fifth National Carbide factor as an absolute and mandatory prohibition of common ownership.[31]

6. Further, the Litany of Nominee Cases is inconsistent in the significance placed on the payment of an agency fee by the principal to the nominee. The failure to pay a nominal fee to a corporation having no material worth, for an admittedly essential serv-

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31. George, supra at 147 (5th Cir.).

ice but one having no significant value is hardly a substantive basis for a determination of agency relationship in a multimillion dollar project.

ARGUMENT

A. THE NATURE OF THE RELATIONSHIP.

Although refusing to find that the subsidiaries in National Carbide were agents of the parent, this Court acknowledged in dictum that a corporation may be a true agent of its owners.[32] Petitioner's brief maintains "the courts below ... have extended the narrow exception far beyond its intended confines by failing to adhere to the specific limitations articulated by this Court."[33] In direct contradictions to

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32. National Carbide, supra at 437.

33. Petitioner's Brief at 26. (Emphasis added.)

this statement, however, Petitioner also maintains "the opinion in National Carbide did not exhaustively analyze the circumstances under which a 'true corporate agen[cy]' could be recognized."[34] In the government's own terms, since the "narrow exception" of National Carbide was "not exhaustively analyzed", it is reasonable that the dictum be expanded based on an appropriate analysis.

The first four National Carbide factors have not generally raised any difficulty. The fifth and sixth factors, as noted in the Statement, have been the subject of a variety of interpretations.

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34. Petitioner's Brief at 23.

B. THE NATURE OF AGENCY RELATIONSHIP.

The notion that the National Carbide dictum means that the principal/agency relationship must also meet an arm's length test between the nominee and its shareholders seems to be stretching the dictum beyond reasonable proportions. In the context of National Carbide, where the claimed agent had too much substance to be disregarded as a taxable entity, this Court was merely pointing out that the control shareholders normally exert over a corporation is not enough, standing alone, to create an agency relationship. Other factors must be present -- factors this Court could not find in National Carbide.

1. Agency Agreements Are Not Arm's Length Agreements.

The Fourth Circuit in Ourisman asserted that the fifth National Carbide factor can only be met if the relationship between the principal and its agent reflects an arm's length agreement, which it defined as follows:

1. The identity of ownership interest in the principal and the agent;

2. Limitation of corporate purposes and powers so that the corporation may only act as an agent;

3. Whether the agent acts for a third party;

4. The existence of a written agency contract; and

5. The receipt of a reasonable fee by the agent for services rendered as an agent.[35]

The fallacy with this arm's length approach in determining the true agency relationship is the fact that agency relations are not always at arm's length.[36] In circumstances other than those involving nominee corporations, agency relationships that are not arm's length are treated for tax purposes according to the true economic effect of the relationship.[37] The legal rights of the principal, agent, and third parties are not affected whether or not the relationship was established on an arm's length basis.[38] The difference between

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35. Ourisman, supra, 760 F.2d 541, 548.

36. Restatement (Second) of Agency, Section 16 (1958).

37. Rev. Rul. 65-282, C.B. 1965-2, 21; Rev. Rul. 58-220, C.B. 1958-1, 26.

38. Restatement (Second) of Agency, Section 16 (1958).

an agency relationship and a corporate shareholder relationship, therefore, is more than mere form.[39]

If the Fourth Circuit's meaning of an arm's length relationship is that both parties will bargain to gain the best economic benefit for each party, then the factors listed above, with the exception of identity of ownership interest, are irrelevant.[40] The other four factors recited by the Fourth Circuit can all be produced where the agent is not interested in maximizing its economic gain from the transaction and,

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39. Restatement (Second) of Agency, Section 14, Comment c (1958).

40. Restatement (Second) of Agency, Section 16 (1958).

therefore, the agency agreement is not an arm's length agreement.

2. The Agency Fee.

The Fourth and Fifth Circuits have placed significance on the payment of an agency fee. Indeed, Petitioner argues absence of an arm's length relationship because the nominee did not receive "... any compensation whatsoever for performing very valuable, indeed essential, services for the ... ventures over a period of several years."[41] While the nominee services were essential, Amici resists the notion that they had anything other than de minimis value. Given the minimal duties imposed on the agent, compensation to the nominee, even if nominal in amount, seems unnecessary

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41. Petitioner's Brief at page 13.

and merely exalts form over substance.

In Frink and George, an unrelated third party nominee, Conduit, was prepared to charge $1,000 for its services as agent. Opposition by the lender to the use of Conduit led to the use of a nominee owned by a 60% partner. Addressing the subject of fee, the Fifth Circuit said:

> "That Conduit would have charged $1,000 for the same services that [the nominee] performed without any promise of compensation buttresses our conclusion that [the principal] did not deal at arm's length with [the nominee] (although [the nominee] did receive a fee of $100).[42]

In George, the partnership undertook an $8,000,000 construction project. Whether Conduit or a controlled nominee

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42. George v. Commissioner, 803 F.2d 144 (5th Cir. 1986) (emphasis added).

was the agent, the fact is that neither of these nominees had any material value as corporate entities. Certainly, if the George decision is buttressed on the failure of the principal to pay an additional $900 fee to a worthless nominee in an $8,000,000 project, then its foundation is flawed.

Indeed, compensation is not essential to a true agency relationship. Gratuitous agencies are commonly used to transact business.[43]

The Tax Court in Bollinger dismissed the absence of a nominal fee as immaterial:

> Although [the agent corporation] was not compensated for services it performed, ... we believe that the agency relationship was not based upon

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43. Rev. Rul. 65-282 and 58-220, supra note 37.

the partners' ownership and control of both entities.[44]

3. Specialty Court Opinions Should Prevail Over Others.

Particular weight should be given to the readily supportable interpretation and application of National Carbide by the Tax Court because of its position as this nation's specialty court in the field of taxation. As the Tax Court noted in Ourisman, the "crucial question" in determining the existence of a true agency "concerns the essential nature of the relationship between the purported corporate agent and its shareholders."[45] It is clear from National Carbide that the determination of

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44. Bollinger, 48 T.C.M. (CCH) 1443 at 1451 (App. C at pages 31a and 32a).

45. Ourisman, supra at 185.

an agency relationship requires an evaluation of the corporate/shareholder relationship in light of standard agency characteristics.

C. OTHER INDICIA OF AGENCY REQUIRED.

Apart from the control shareholders have of their corporation, there must be other indicia of agency sufficient to establish the existence of an agency relationship between the corporation and its shareholders.

Contrary to the position taken by the Fourth and Fifth Circuits, the fifth factor, when read in context, is not intended as a special, absolute factor. Rather, as interpreted by the Tax Court, the Sixth Circuit, and other authorities, other factors in addition to shareholders' control are required to

establish that the corporation is a true agent.

> The corporation must establish that it is an agent for its shareholders ... by evidence other than the control which shareholders automatically possess over their corporations. If the corporation merely holds title to property, and the management functions are carried on by the shareholders, it is comparatively easy to infer that the corporation is acting only as an agent or nominee ...[46]

Certainly, shareholders control the activities of their corporations, and corporations to an extent act on behalf of their shareholders. The existence of these truisms, however, do not support the Fifth Circuit's conclusion in Roccaforte that their existence alone is

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46. Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders, paragraph 2.10, at page 2-28 to 2-29, 1979 edition.

determinative of an agency relationship. To so hold, would render meaningless the separate existence doctrine of corporations as set forth in Moline Properties.

In National Carbide, it was not enough that the parent owned the subsidiaries and that the subsidiaries acted on behalf of the parent corporation. Agency had to be established by factors independent of the control and ownership exercised by the parent over the subsidiaries.

Similarly, shareholder control is not enough in Bollinger, Roccaforte, Ourisman, and Frink, to establish an agency relationship. Rather, principal/agent relationship had to be established by reference to all of the standard agency factors listed in National Car-

bide. This interpretation of National Carbide is supported by the language immediately following the delineation of the factors:

> Absence of the factors mentioned above, and the essentiality of ownership of the corporation to the existence of an agency relationship in the Moline ... and Southern Pacific cases, indicate the fallacy of the agency argument made in those cases. (Emphasis added.)[47]

In other words, in the two cases cited, the standard factors characteristic of a principal relationship were lacking, and furthermore, the only evidence of the agency relationship was the fact of shareholder ownership and control of the corporation.

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47. National Carbide, supra at 437-438.

In any of the Litany of Nominee Cases, the relations between the corporation as agent and its shareholders as principals will necessarily be based in part, if not entirely, on the control that the individual or the partners, as shareholders, exercise over the corporation. To suggest otherwise, as was done in Roccaforte and Ourisman, is to ignore reality. This does not foreclose an agency relationship, however. The fact that the relations between the principal and the agent are based on the control maintained by the principal over its wholly owned corporation cannot be determinative of the principal/agency issue.

D. PROTECTION OF CORPORATE INTEGRITY.

The concern that recognizing the nominee status of a corporation would allow shareholders to ignore the separate existence of the corporation whenever convenient is not persuasive. The Tax Court emphasized that the taxpayer's purpose in using the nominee corporation was strictly to avoid state usury limitations.[48] The Tax Court found that the corporations engaged only in activities consistent with this limited agency purpose, that the nominee activities were negligible, that the taxpayers did not avail themselves of any of the traditional benefits of the

48. Roccaforte, supra, 77 T.C. 263, 288; Frink, supra, 49 T.C.M. (CCH) 1443; Bollinger, supra, 48 T.C.M. (CCH) 1443 (App. C, 14a); Bollinger, supra, 807 F.2d 65 at 68, 69 (App. A, 1a).

corporate form (including limited liability), and that the corporation's limited status as an agent was known to the lenders.

Under these circumstances, the tax treatment of corporations as separate entities is not threatened. Furthermore, considering that the limited use of the corporate form in these agency cases is certainly an exception and not the rule, the concern of the Fourth and Fifth Circuits is overstated.

> [This Court] should follow the lead of the Tax Court [and the Sixth Circuit] in recognizing that a true agency can exist between a corporation and its shareholders even though the actual relationship between the corporation and its principal (the shareholders) depends on the fact of common ownership and control.[49]

49. Burke, supra, note 16 at 293.

E. THE APPROPRIATE AGENCY STANDARDS.

Authoritative authors (including a former Commissioner of Internal Revenue) appear unanimous in their criticism of the pro-government positions taken by the Fourth and Fifth Circuits.[50] In their collective opinions, the general standards of recognizing a nominee corporation, regardless of stock ownership, might be some of the following:

1. Disclosure in the articles of incorporation, appropriate agreements, and/or corporate resolutions that the corporation's business is acting as agent or nominal title holder for the beneficial owner;

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50. Meanor, supra note 29; Burke, supra note 16; Kurtz, supra note 2; Green, supra note 29.

2. The nominee and principal terminate the agency relationship upon notice from the beneficial owner, and re-transfer legal title to such owner when the substantive advantage of nominee record ownership has passed;

3. All income and expenses with respect to the property are paid to and out of the beneficial owner's bank account;

4. In dealings with others, specifically with lenders, it is generally understood that the corporation is acting as an agent for its principal; and

5. The beneficial owner neither seeks nor receives tax benefit from operating in corporate form.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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